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Listing Standards for Recovery of Erroneously Awarded Compensation; Proposed Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 229, 240, 249, and 274

[RELEASE NOS. 33–9861; 34–75342; IC–31702; File No. S7–12–15]

RIN 3235–AK99

Listing Standards for Recovery of Erroneously Awarded Compensation

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing a new rule and rule and form amendments to implement the provisions of Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which added Section 10D to the Securities Exchange Act of 1934. Section 10D requires the Commission to adopt rules directing the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with Section 10D's requirements for disclosure of the issuer's policy on incentive-based compensation and recovery of incentive-based compensation that is received in excess of what would have been received under an accounting restatement. The proposed rule and rule amendments would direct the national securities exchanges and national securities associations to establish listing standards that would require each issuer to develop and implement a policy providing for the recovery, under certain circumstances, of incentive-based compensation based on financial information required to be reported under the securities laws that is received by current or former executive officers, and require the disclosure of the policy. A listed issuer would be required to file the policy as an exhibit to its annual report.

DATES: Comments should be received on or before September 14, 2015.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/proposed.shtml*);
- Send an email to *rule-comments@sec.gov;* or
- Use the Federal Rulemaking ePortal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090.

All submissions should refer to File Number S7–12–15. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/proposed.shtml*). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the SEC's Web site. To ensure direct electronic receipt of such notifications, sign up through the ''Stay Connected'' option at *www.sec.gov* to receive notifications by email.

FOR FURTHER INFORMATION CONTACT: Anne Krauskopf, Senior Special Counsel, or Carolyn Sherman, Special Counsel at (202) 551–3500, in the Office of Chief Counsel, Division of Corporation Finance, or Joel K. Levine, Associate Chief Accountant at (202) 551–3400, in the Office of Chief Accountant, Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549.

SUPPLEMENTARY INFORMATION: We are proposing to add new Rule 10D–1 [1] under the Securities Exchange Act of 1934.[2] We also are proposing amendments to Items 402,[3] 404 [4] and 601 [5] of Regulation S–K,[6] Item 22 of Schedule 14A,[7] Exchange Act Forms 20–F [8] and 40–F,[9] and Form N–CSR [10] under the Exchange Act and the Investment Company Act of 1940.[11]

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[1] 17 CFR 240.10D–1.
[2] 15 U.S.C. 78a *et seq.*
[3] 17 CFR 229.402.
[4] 17 CFR 229.404.
[5] 17 CFR 229.601.
[6] 17 CFR 229.10 *et seq.*
[7] 17 CFR 240.14a–101.
[8] 17 CFR 249.220f.
[9] 17 CFR 249.240f.
[10] 17 CFR 249.331 and 274.128.
[11] 15 U.S.C. 80a–1 *et seq.*

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I. Background and Summary

We are proposing a new rule, and rule and form amendments to implement the provisions of Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the ''Act''),[12] which added Section 10D to the Securities Exchange Act of 1934 (the ''Exchange Act''). Specifically, Section 10D(a) of the Exchange Act requires the Commission to adopt rules directing the national securities exchanges [13] (the ''exchanges'') and the national securities associations [14] (the ''associations'') to prohibit the listing of any security of an issuer that is not in compliance with the requirements of Section 10D(b). Section 10D(b) requires the Commission to adopt rules directing the exchanges to establish listing standards to require each issuer to develop and implement a policy providing:

(1) For the disclosure of the issuer's policy on incentive-based compensation that is based on financial information required to be reported under the securities laws; and

(2) that, in the event that the issuer is required to prepare an accounting restatement due to the issuer's material noncompliance with any financial reporting requirement under the securities laws, the issuer will recover from any of the issuer's current or former executive officers who received incentive-based compensation (including stock options awarded as compensation) during the three-year period preceding the date the issuer is required to prepare the accounting restatement, based on the erroneous data, in excess of what would have been paid to the executive officer under the accounting restatement.

Other statutes and rules currently administered by the Commission also address the recovery of executive compensation:

- Section 304 of the Sarbanes-Oxley Act of 2002 (''SOX'') [15] provides that if an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct,[16] with any financial reporting requirements under the securities laws, the chief executive officer and chief financial officer of the issuer shall reimburse the issuer for any bonus or other incentive-based or equity-based compensation received by

[12] Public Law 111–203, 124 Stat. 1900 (2010).

[13] A ''national securities exchange'' is an exchange registered as such under Section 6 of the Exchange Act [15 U.S.C. 78f]. There are currently eighteen exchanges registered under Section 6(a) of the Exchange Act: BATS Exchange, BATS Y-Exchange, BOX Options Exchange, C2 Options Exchange, Chicago Board Options Exchange, Chicago Stock Exchange, EDGA Exchange, EDGX Exchange, International Securities Exchange (''ISE''), ISE Gemini, Miami International Securities Exchange, NASDAQ OMX BX, NASDAQ OMX PHLX, The NASDAQ Stock Market, National Stock Exchange, New York Stock Exchange (''NYSE''), NYSE Arca and NYSE MKT. Certain exchanges are registered with the Commission through a notice filing under Section 6(g) of the Exchange Act for the purpose of trading security futures. As discussed in Section II.A.2, below, we propose to exempt security futures products and standardized options from the scope of the proposed rule. To the extent that our final rule exempts the listing of security futures products and standardized options from its scope, any registered national securities exchange that lists and trades only security futures products or standardized options would not be required to file a rule change in order to comply.

[14] A ''national securities association'' is an association of brokers and dealers registered as such under Section 15A of the Exchange Act [15 U.S.C. 78o–3]. The Financial Industry Regulatory Authority (''FINRA'') is the only association registered with the Commission under section 15A(a) of the Exchange Act. Because FINRA does not list securities, generally we refer only to the exchanges in this release. However, if any associations were to list securities, the rule proposals would apply to them also.

In addition, Section 15A(k) of the Exchange Act (15 U.S.C. 78o–3(k) provides that a futures association registered under Section 17 of the Commodity Exchange Act (7 U.S.C. 21) shall be registered as an association for the limited purpose of regulating the activities of members who are registered as broker-dealers in security futures products pursuant to Section 15(b)(11) of the Exchange Act (15 U.S.C. 78o(b)(11)).

[15] 15 U.S.C. 7243.

[16] The CEO or CFO need not personally engage in misconduct for recovery to be required under Section 304. See *SEC* v. *Jenkins,* 718 F.Supp. 2d 1070, 1074–75 (D. Ariz. 2010) (''[T]he misconduct of the issuer is the misconduct that triggers the reimbursement obligation of the CEO and the CFO.''); *SEC* v. *Baker,* 2012 U.S. Dist. LEXIS 161784 (W.D. Tex 2012).

that person from the issuer during the 12-month period following the first public issuance or filing with the Commission (whichever first occurs) of the financial document embodying such financial reporting requirement; and any profits realized from the sale of securities of the issuer during that 12-month period; and

• Item 402(b) of Regulation S–K includes, as an example of the kind of information that should be addressed, if material, in the company's Compensation Discussion and Analysis (''CD&A''), company policies and decisions regarding the adjustment or recovery of awards or payments to named executive officers [17] if the relevant company performance measures upon which they are based are restated or otherwise adjusted in a manner that would reduce the size of an award or payment.[18]

The proposed rule and rule amendments would supplement these existing provisions by directing the exchanges to establish listing standards that require listed issuers to:

• Adopt and comply with written policies for recovery of incentive-based compensation based on financial information required to be reported under the securities laws, applicable to the listed issuers' executive officers, over a period of three years; and

• disclose those recovery policies in accordance with Commission rules.

To assure that issuers listed on different exchanges are subject to the same disclosure requirements regarding compensation recovery policies, we are proposing amendments to the disclosure rules that would require all issuers listed on any exchange to file their written recovery policy as an exhibit to their annual reports and, if they have taken actions pursuant to that policy, to disclose those actions.

Under the proposed rule and rule amendments, an issuer would be subject to delisting if it does not:

• Adopt a compensation recovery policy that complies with the applicable listing standard;

• disclose the policy in accordance with Commission rules, including providing the information in tagged data format; or

• comply with the policy's recovery provisions.

Listed issuers could, of course, adopt policies more extensive than those called for by the listing standards, so long as those policies at a minimum satisfied the listing standards, and exchanges and associations could adopt listing standards with requirements that are more extensive than those of proposed Rule 10D–1.

II. Discussion of the Proposals

We are proposing new Exchange Act Rule 10D–1 to set forth the listing requirements that exchanges would be directed to establish pursuant to Section 10D of the Exchange Act. We also are proposing rule amendments to Regulation S–K, to the forms by which foreign private issuers file their Exchange Act annual reports, and for certain investment companies, to Form N–CSR and Schedule 14A. These amendments would require disclosure of the listed issuer's policy on recovery of incentive-based compensation and information about actions taken pursuant to such recovery policy. In developing these proposals, we considered the comment letters we received on Section 10D pursuant to our initiative to receive advance public comment in implementing the Act.[19]

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

1. General

Section 10D of the Exchange Act provides that the Commission shall, by rule, direct the exchanges ''to prohibit the listing of any security of an issuer that does not comply with the requirements of [Section 10D].'' Commenters raised questions as to whether the rule should apply to all issuers with listed securities, such as foreign private issuers [20] and issuers of listed debt whose stock is not also listed.[21]

For the reasons discussed below, the rule and rule amendments we propose would require exchanges to apply the disclosure and recovery policy requirements to all listed issuers, with only limited exceptions. As a preliminary matter, we read the language of Section 10D as generally calling for a broad application of the mandated listing standards. Section 10D does not distinguish among issuers or types of securities, and does not specifically instruct the Commission to exempt any particular types of issuers or securities or direct the Commission to permit the exchanges to provide such exemptions in listing them.[22] We recognize, however, that we could use our general exemptive authority under the Exchange Act [23] to exempt specific categories of issuers or securities to the extent that doing so would be necessary or appropriate in the public interest and consistent with the protection of investors. In evaluating whether to exempt specific categories of issuers and securities, though, we have considered whether providing exemptions from the requirements of Section 10D would be

[17] As defined in Item 402(a)(3) of Regulation S–K, ''named executive officers'' are all individuals serving as the company's principal executive officer during the last completed fiscal year, all individuals serving as the company's principal financial officer during that fiscal year, the company's three other most highly compensated executive officers who were serving as executive officers at the end of that year, and up to two additional individuals who would have been among the three most highly compensated but for not serving as executive officers at the end of that year.

[18] Item 402(b)(2)(viii). Item 402(b) contains the requirements for CD&A, which is intended to be a narrative overview that puts into context the executive compensation disclosure provided in response to the other requirements of Item 402. The CD&A disclosure requirement is principles-based, in that it identifies the disclosure concept and provides several non-exclusive examples. Under Item 402(b)(1), companies must explain all material elements of their named executive officers' compensation by addressing mandatory principles-based topics in CD&A. Item 402(b)(2) sets forth nonexclusive examples of the kind of information that should be addressed in CD&A, if material.

[19] In connection with all of the Dodd-Frank Act rulemakings, we sought comment from the public prior to the issuance of a proposing release. Comments related to the executive compensation provisions of the Dodd-Frank Act are available at *http://www.sec.gov/comments/df-title-ix/executive-compensation/executive-compensation.shtml.* Regarding Section 10D, we received pre-proposal letters from AFL–CIO, Americans for Financial Reform, As You Sow, Center for Effective Government, Demos, Institute for Policy Studies/Global Economy Project, International Brotherhood of Teamsters, Other98.org, Public Citizen and Service Employees International Union (''AFL–CIO Joint Letter''); American Benefits Council; Baker, Donelson, Bearman, Caldwell & Berkowitz, PC; Brian Foley & Company, Inc.; Center on Executive Compensation; Clark Consulting, LLC; Committee on Federal Regulation of Securities of the Section of Business Law of the American Bar Association (''ABA Business Law Section''); Compensia, Inc.; Davis Polk & Wardwell LLP; Frederic W. Cook & Co., Inc.; Mai Datta, Ph.D., Professor of Finance, Wayne State University; Stuart R. Lombardi; Meridian Compensation Partners, LLC; PGGM Investments; Pay Governance LLC; Protective Life Corporation; Robert E. Scully Jr., Member, Stites Harbison, PLLC; Society of Corporate Secretaries and Governance Professionals; Towers Watson; and Sheila Waddell.

[20] *See* letters from ABA Business Law Section (noting that foreign private issuers are not required to comply with the proxy rules or Item 402 executive compensation disclosure, and that home countries may have a greater interest in determining whether companies should have recourse against their executives) and Brian Foley & Company, Inc. (seeking clarification whether Section 954 applies to foreign private issuers).

[21] *See* letter from Brian Foley & Company, Inc.

[22] In this regard, Section 10D differs from the Act's other governance-related provisions, such as Section 951 Shareholder Vote on Executive Compensation Disclosure (amending the Exchange Act to add Section 14A) and Section 952 Compensation Committee Independence (amending the Exchange Act to add Section 10C), which include specific direction for either the Commission or the exchanges to consider exemptions for classes of issuers, or to provide exemptions. Additionally, Section 951 instructs the Commission to take into account whether Section 951's requirements disproportionately burden small issuers.

[23] Section 36(a) of the Exchange Act (15 U.S.C. 78mm(a)).

consistent with what we understand to be the purpose of this statutory provision. In this regard, we note that a report by the Senate Committee on Banking, Housing and Urban Affairs stated that ''[t]his proposal will clarify that all issuers must have a policy in place to recover compensation based on inaccurate accounting so that shareholders do not have to embark on costly legal expenses to recoup their losses or so that executives must return monies that should belong to the shareholders.'' [24] As discussed below, we propose to exempt security futures products, standardized options, and the securities of certain registered investment companies from the proposed listing standards because we believe the compensation structures of issuers of these securities render application of the rule and rule amendments unnecessary.[25] We are not proposing otherwise to exempt categories of listed issuers, such as emerging growth companies,[26] smaller reporting companies,[27] foreign private issuers,[28] and controlled companies,[29] because we believe the objective of recovering excess incentive-based compensation is as relevant for these categories of listed issuers as for any other listed issuer. In reaching this conclusion, we also considered the relative burdens of compliance on these categories of issuers. As discussed more fully in the Economic Analysis, while we recognize that the proposed listing standards could, in certain respects, impose a disproportionate burden on these categories of issuers, there is also reason to believe that these issuers, as well as investors and the markets in general, may derive benefits from being subject to the proposed listing standards.[30]

In our determination of whether to propose exemptions for foreign private issuers we considered the views of commenters that submitted comments before this proposal [31] as well as the incidence of restatements among this category of listed issuers. We are aware of studies that indicate that these issuers, from time to time, restate their financial statements to correct accounting errors.[32] For example, during 2012 and 2013 foreign private issuers, which are approximately 10 percent of all registrants, accounted for over 10 percent of all restatements.[33]

Although some exchange listing standards permit foreign private issuers to follow home country practice in lieu of certain corporate governance requirements,[34] our proposed rule and rule amendments would not permit the exchanges to exempt foreign private issuers from compliance with Section 10D's disclosure and recovery requirements. Consistent with a comment we received,[35] our proposal would, however, allow exchanges to permit foreign private issuers to forgo recovery as impracticable if the recovery of erroneously awarded compensation pursuant to Section 10D would violate the home country's laws so long as certain other conditions are met.[36]

We also considered the incidence of restatements for smaller reporting companies, emerging growth companies and controlled companies in determining not to exclude such companies from these requirements. For example, during 2012 and 2013, U.S. issuers who are not accelerated filers [37] accounted for approximately 55 percent of total U.S. issuer restatements.[38]

We believe that smaller reporting companies constitute a substantial majority of U.S. non-accelerated filers. We also believe that at least some of these categories of issuers use incentive-based compensation arrangements that are based on achievement of financial reporting measures that may be affected by accounting restatements. As a result, we believe that shareholders of these listed issuers would benefit from a policy to recover excess incentive-based compensation and that applying the proposed rule and rule amendments to these issuers will further the statutory goal of assuring that executive officers do not retain incentive-based compensation that they received erroneously. For similar reasons, we are not proposing to grant the exchanges discretion to decide whether additional categories of issuers should be exempted from the proposed listing standards.

Further, Section 10D refers to ''any security'' of an issuer, which would include not only common equity securities, but also debt and preferred

[24] *See* Report of the Senate Committee on Banking, Housing, and Urban Affairs, S.3217, Report No. 111–176 at 135–36 (April 30, 2010) (''Senate Report'').

[25] *See* Sections II.A.2 and 3, below.

[26] Section 2(a)(19) of the Securities Act of 1933 (the ''Securities Act'') and Exchange Act Section 3(a)(80) define ''emerging growth company'' as ''an issuer that had total annual gross revenues of less than $1,000,000,000 . . . during its most recently completed fiscal year.'' An issuer shall continue to be deemed an emerging growth company until the earliest of (1) the last day of the fiscal year during which it had total annual gross revenues of $1 billion; (2) the last day of the fiscal year following the fifth anniversary of the first sale of its common equity securities; (3) the date on which it has issued more than $1 billion in non-convertible date during the previous three years; or (4) the date on which it is deemed a large accelerated filer.

[27] Exchange Act Rule 12b–2 defines ''smaller reporting company'' as ''an issuer that is not an investment company, an asset-backed issuer . . ., or a majority-owned subsidiary of a parent that is not a smaller reporting company and that: (1) Had a public float of less than $75 million as of the last business day of its most recently completed second fiscal quarter, computed by multiplying the aggregate worldwide number of shares of its voting and non-voting common equity held by non-affiliates by the price at which the common equity was last sold, or the average of the bid and asked prices of common equity, in the principal market for the common equity; or (2) in the case of an initial registration statement under the Securities Act or Exchange Act for shares of its common equity, had a public float of less than $75 million as of a date within 30 days of the date of the filing of the registration statement, computed by multiplying the aggregate worldwide number of such shares held by non-affiliates before the registration plus, in the case of a Securities Act registration statement, the number of such shares included in the registration statement by the estimated public offering price of the shares; or (3) in the case of an issuer whose public float as calculated under paragraph (1) or (2) of this definition was zero, had annual revenues of less than $50 million during the most recently completed fiscal year for which audited financial statements are available.'' Whether or not an issuer is a smaller reporting company is determined on an annual basis.

[28] Exchange Act Rule 3b–4(c) defines ''foreign private issuer'' as ''any foreign issuer other than a foreign government except for an issuer meeting the following conditions as of the last business day of its most recently completed second fiscal quarter: (1) More than 50 percent of the issuer's outstanding voting securities are directly or indirectly held of record by residents of the United States; and (2) (i) the majority of the executive officers or directors are United States citizens or residents, (ii) more than 50 percent of the assets of the issuer are located in the United States, or (iii) the business of the issuer is administered principally in the United States.'' Exchange Act Rule 3b–4(b) defines ''foreign issuer'' as ''any issuer which is a foreign government, a national of any foreign country or a corporation or other organization incorporated or organized under the laws of any foreign country.''

[29] Under New York Stock Exchange Rule 303A.00 and NASDAQ Stock Market LLC Rule 5615(c) a ''controlled compan[y]'' is defined as a company of which more than 50% of the voting power for the election of directors is held by an individual, group or another company.

[30] *See* Section III, below.

[31] *See* letters from Brian Foley & Company, Inc. (seeking clarification of whether Section 954 would apply to foreign private issuers and listed debt where the issuer's equity is not listed); ABA Business Law Section(recommending the Commission exercise its authority to exempt foreign private issuers from Section 954 rulemaking).

[32] *See* 2013 Financial Restatements: A Thirteen Year Comparison, Audit Analytics (2014) (''A Thirteen Year Comparison'') (addressing accelerated foreign filers, non-accelerated foreign filers, accelerated U.S. filers, and non-accelerated U.S. filers), and Financial Restatement Trends in the United States: 2003–2012, Professor Susan Scholz, University of Kansas, Study Commissioned by the Center for Audit Quality (comparing U.S. and foreign issuers).

[33] *See* A Thirteen Year Comparison.

[34] *See, e.g.,* New York Stock Exchange Rule 303A.00 and NASDAQ Stock Market LLC Rule 5615(a)(3).

[35] *See* letter from ABA Business Law Section.

[36] *See* Section II.C.3.b, below, for a discussion of proposed board discretion in these circumstances.

[37] As defined in Exchange Act Rule 12b–2 [17 CFR 240.12b–2].

[38] *See* A Thirteen Year Comparison.

securities. Accordingly, apart from the proposed exemptions discussed below, we are proposing that the listing standards and other requirements of the proposed rule and rule amendments apply without regard to the type of securities issued, including to issuers of listed debt or preferred securities that do not have listed equity. As described in the Economic Analysis,[39] the potential benefits of a recovery policy would likely accrue to the holders of debt and preferred securities as well as to equity holders. For the same reasons, we do not propose to grant the exchanges discretion to decide whether certain categories of securities should be exempted from the proposed listing standards.

Request for Comment

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.

2. Should we distinguish among listed issuers based on the types of securities listed? Please explain the rationale for any such exemption. For example, do issuers with listed non-convertible debt or preferred stock that do not have listed common equity raise the same concerns as issuers with listed common equity? For listed issuers that do not have listed common equity, do the different residual claims against the cash flows of the issuer warrant a different treatment?

3. Would the proposed listing standards conflict with any home country laws, stock exchange requirements, or corporate governance arrangements that apply to foreign private issuers? If so, please explain the nature of those conflicts. Should the proposed rule and rule amendments allow exchanges to permit foreign private issuers to forego recovery of erroneously awarded compensation if recovery would violate the home country's laws and certain conditions were met, as proposed? Is such an exception necessary or appropriate? If no, why not? If not, are there more appropriate or effective means to address such conflicts?

4. In the event that a foreign private issuer's home country has a law that like Section 10D requires the issuer to disclose its policies on incentive-based compensation and recover erroneously awarded incentive-based compensation from current or former executive officers,[40] should the foreign private issuer be permitted to comply with its home country law instead of complying with the listing standard of the U.S. exchange that lists the foreign private issuer's securities? Please explain why or why not.

5. Should there be a mechanism to determine whether additional categories of issuers and/or securities should be exempted from the proposed listing standards? If so, what mechanism would be appropriate? Should new financial products that may be developed in the future be subject to the proposed requirements? Why or why not? What principles or requirements, if any, should apply to any mechanism? In the absence of a discretionary mechanism for future exemptions, would the proposed rule potentially hinder competition? If so, how?

2. Securities Futures Products and Standardized Options

The Exchange Act's definition of ''equity security'' includes any security future on any stock or similar security.[41] Exchanges registered under Section 6 of the Exchange Act and associations registered under Section 15A(a) of the Exchange Act may trade futures on individual securities and on narrow-based security indexes (''securities futures products'')[42] without such securities being subject to the registration requirements of the Securities Act of 1933 (''Securities Act'') and the Exchange Act so long as they are cleared by a clearing agency that is registered under Section 17A of the Exchange Act or that is exempt from registration under Section 17A(b)(7) of the Exchange Act.[43] In December 2002, we adopted rules to provide comparable regulatory treatment for standardized options.[44]

The role of a clearing agency as the issuer for security futures products and standardized options is fundamentally different from that of other listed issuers.[45] The purchaser of security futures products and standardized options does not, except in the most formal sense, make an investment decision regarding the clearing agency. As a result, information about the clearing agency's business, its officers and directors and their compensation, and its financial statements is less relevant to investors in these securities than information about the issuer of the underlying security.[46] Moreover, the investment risk in security futures products and standardized options is largely determined by the market performance of the underlying security rather than the performance of the clearing agency, which is a self-regulatory organization subject to regulatory oversight.

In recognition of such fundamental differences, the Commission provided exemptions for security futures products and standardized options when it adopted the audit committee listing requirements in Exchange Act Rule10A–3[47] and the compensation committee listing requirements in Exchange Act Rule 10C–1.[48] Specifically, these rules exempt the listing of a security futures

[39] *See* Section III, below.

[40] *See, e.g.,* the UK Corporate Governance Code, September 2014, available at *https://frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf.* Under Section D. of the Corporate Governance Code, a company's remuneration scheme for executive directors for performance-related remuneration should ''include provisions that would enable the company to recover sums paid or withhold the payment of any sum, and specify the circumstances in which it would be appropriate to do so.'' *See also, e.g.,* Directive 2013/36/EU of the European Parliament and of the Council of June 26, 2013, available at *http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013L0036.* The EU Capital Requirements Directive IV includes specific requirements on compensation, including a bonus cap up to 100% of variable remuneration or, with shareholder approval, 200% of total fixed pay, which must be subject to ''malus or clawback'' arrangements.

[41] Exchange Act Section 3(a)(11).

[42] Exchange Act Section 3(a)(56) [15 U.S.C. 78c(a)(56)], and Commodities Exchange Act Section 1a(32) [7 U.S.C. 1a(32)] define ''security futures product'' as any security future or any put, call, straddle, option or privilege on any security future.

[43] *See* Securities Act Section 3(a)(14) [15 U.S.C. 77c(a)(14)], Exchange Act Section 12(a) [15 U.S.C. 78l(a)], and Exchange Act Rule 12h–1(e) [17 CFR 240.12h–1(e)].

[44] *See* Release No. 33–8171 (Dec. 23, 2002) [68 FR 188]. In that release, we exempted standardized options issued by registered clearing agencies and traded on a registered exchange or on a registered association from all provisions of the Securities Act, other than the antifraud provision of Section 17, as well as the Exchange Act registration provisions. Standardized options are defined in Exchange Act Rule 9b–1(a)(4) [17 CFR 240.9b–1(a)(4)] as option contracts trading on an exchange, an automated quotation system of a registered association, or a foreign securities exchange which relate to option classes the terms of which are limited to specific expiration dates and exercise prices, or such other securities as the Commission may, by order, designate.

[45] *See* Fair Administration and Governance of Self-Regulatory Organizations; Disclosure and Regulatory Reporting by Self-Regulatory Organizations; Recordkeeping Requirements for Self-Regulatory Organizations; Ownership and Voting Limitations for Members of Self-Regulatory Organizations; Ownership Reporting Requirements for Members of Self-Regulatory Organizations; Listing and Trading of Affiliated Securities by a Self-Regulatory Organization, Release No. 34–50699 (Nov. 18, 2004) [69 FR 71126], at n. 260 (''Standardized options and security futures products are issued and guaranteed by a clearing agency.'')

[46] *See Listing Standards for Compensation Committees,* Release No. 33–9199 (Mar. 30, 2011) at Section II.B.2.b.

[47] *See* Exchange Act Rules 10A–3(c)(4) and (5).

[48] *See* Exchange Act Rules 10C–1(b)(5)(iii) and (iv).

product cleared by a clearing agency that is registered pursuant to Section 17A of the Exchange Act or that is exempt from registration pursuant to Section 17A(b)(7)(A) and the listing of a standardized option issued by a clearing agency that is registered pursuant to Section 17A of the Exchange Act. For the reasons that we exempted these securities from Rules 10A–3 and 10C–1, and because any relationship between any incentive-based compensation that the clearing agency pays its executive officers and its financial statements would not be significant to investors in these futures and options, we propose to exempt these securities from the requirements of proposed Rule 10D–1.[49]

Request for Comment

6. Are our proposed exemptions for listing securities futures products and standardized options appropriate? Why or why not?

7. Are there other types of securities that we should consider exempting from Rule 10D–1? If so, please explain which securities we should exempt and why.

3. Registered Investment Companies

In some cases, registered investment companies list their securities on an exchange. These registered investment companies generally include closed-end management investment companies and certain open-end management investment companies and unit investment trusts (''UITs'') that operate as exchange-traded funds (''ETFs'').[50] Listed registered management investment companies, unlike most other issuers, are generally externally managed and often have few, if any, employees that are compensated by the registered management investment companies, (*i.e.,* the issuers). Instead, registered management investment companies typically rely on employees of the investment adviser to manage fund assets and carry out other related business activities. Such employees are typically compensated by the investment adviser of the registered management investment company as opposed to the fund. There are a small number of listed registered management investment companies that are internally managed. Such internally managed registered management investment companies might pay executive officers incentive-based compensation, as defined in proposed Rule 10D–1.

We believe that a listed registered management investment company[51] should be subject to the requirements of proposed Rule 10D–1 only to the extent that it pays executive officers incentive-based compensation. Accordingly, we propose to exempt the listing of any security issued by a registered management investment company if such management company has not awarded incentive-based compensation to any executive officer of the registered management investment company in any of the last three fiscal years or, in the case of a company that has been listed for less than three fiscal years, since the initial listing.[52] Management investment companies that have paid incentive-based compensation in that time period, however, would be subject to the rule and rule amendments and be required to have implemented a compensation recovery policy like other listed issuers. The conditional exemption would avoid causing management investment companies that do not pay incentive-based compensation to develop recovery policies they may never use.

We are also proposing to exempt the listing of any security issued by a UIT from the requirements of proposed Rule 10D–1.[53] Unlike management investment companies, UITs are pooled investment entities without a board of directors, corporate officers, or an investment adviser to render investment advice during the life of the UIT. In addition, because the investment portfolio of a UIT is generally fixed, UITs are not actively managed. Also, unlike registered management investment companies, UITs do not file a certified shareholder report. Accordingly, we believe that due to their particular structure and characteristics, the requirements of proposed Rule 10D–1 would be inapplicable to UITs.[54]

We are also proposing to amend Form N–CSR to redesignate Item 12 as Item 13[55] and to add new paragraph (a)(3) to that Item. The new paragraph would require any registered management investment company that would be subject to the requirements of proposed Rule 10D–1 to include as an exhibit to its annual report on Form N–CSR its policy on recovery of incentive-based compensation.

We are also proposing to add new Item 12 to Form N–CSR as well as to amend Item 22 of Schedule 14A of the Exchange Act. Both amendments would require registered management investment companies that would be subject to proposed Rule 10D–1 to provide information that would mirror the disclosure requirements of Item 402(w) of Regulation S–K.[56]

Request for Comment

8. Are the exemptions for registered management investment companies and UITs as described above appropriate? Why or why not?

9. Should we conditionally exempt business development companies from the proposed listing standards, to the same extent as we propose to do with registered management investment companies? If so, please explain why.

10. Should we unconditionally exempt registered management investment companies from the proposed listing standards, as we propose to do with UITs? Should we unconditionally exempt registered open-end management investment companies that list their securities on an exchange, and only apply the conditional exemption to closed-end management investment companies? Please explain why.

11. Should we require listed registered management investment companies to disclose in annual reports on Form N–CSR or elsewhere whether or not the registered management investment company has in fact

[49] For these same reasons, we believe exempting such securities from Rule 10D–1 would be in the public interest and consistent with the protection of investors. See Exchange Act Section 36(a).

[50] See Investment Company Act Sections 5(a)(1) (definition of open-end management investment company) and 5(a)(2) (definition of closed-end management investment company) [15 U.S.C. 80a–5(a)]. See also Investment Company Act Section 4(2) (definition of UIT). ETFs are open-end management investment companies or UITs that offer redeemable securities that are listed and trade on an exchange. Since the investment portfolio of a UIT is generally fixed, UITs are not management investment companies. See text following note 48 below.

[51] We note that, as proposed, business development companies, which are a category of closed-end management investment company that are not registered under the Investment Company Act, would be subject to proposed Rule 10D–1. [15 U.S.C. 80a–2(a)(48) and 80a–53–64]. The purpose of business development companies is to fund small and developing businesses. In discussing the amendments to the Investment Company Act that established business development companies, the House Report noted such companies' special purpose and specifically recognized the need for such companies to be able to offer incentive-based compensation to their officers. *See* H.R. Rep. No. 1341, 96th Cong., 2d Sess. 21 (1980). We therefore see no reason to exempt business development companies that list their securities for trading on an exchange from the general requirements of the proposed rule.

[52] Proposed Rule 10D–1(b)(2)(iv). We expect that each exchange and association would adopt the necessary listing standards to ensure that those registered management investment companies that qualify for the exemption have complied with the proposed rule's exemption requirements.

[53] Proposed Rule 10D–1(b)(2)(iii).

[54] For similar reasons, the Commission exempted UITs when it adopted the audit committee listing requirements in Exchange Act Rule 10A–3. *See* Exchange Act Rules 10A–3(c)(6).

[55] We are also proposing a conforming amendment to General Instruction D to Form N–CSR to refer to redesignated Item 13(a)(1).

[56] *See* Section II.D.1, below.

awarded incentive-based compensation to executive officers in the last three fiscal years, or in the case of a registered management investment company that has been listed for less than three fiscal years, since the listing of the registered management investment company? Should a similar disclosure requirement apply to UITs?

B. Restatements

1. Restatements Triggering Application of Recovery Policy

Sections 10D(a) and 10D(b)(2) require exchanges and associations to adopt listing standards that require issuers to adopt and comply with policies that require recovery ''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 Senate Report indicated that Section 10D was intended to result in ''public companies [adopting policies] to recover money that they erroneously paid in incentive compensation to executives as a result of material noncompliance with accounting rules. This is money that the executive would not have received if the accounting was done properly.'' [57] Commenters equested guidance regarding the definition of material noncompliance generally.[58] One commenter recommended that the Commission either identify the circumstances that would constitute material noncompliance with financial reporting requirements or, at a minimum, provide examples of such circumstances as a guide for making such a determination, since the determination of whether or not any noncompliance is material would be based on the facts and circumstances of each situation.[59] In addressing who must make the material noncompliance determination, one commenter noted that Section 10D was unclear as to who must make this determination [60] and others recommended that the determination be left to the issuer.[61]

Two commenters noted that because a restatement would have to be the result of material noncompliance with financial reporting requirements, Congress recognized that not all accounting restatements would require recovery.[62] Several commenters recommended that the Commission exclude restatements based on changes in generally accepted accounting principles from the types of restatements that trigger recovery.[63] Another commenter observed that a change in accounting standards would appear not to trigger recovery, but a change in how an auditor interprets accounting standards may trigger recovery, even absent issues regarding whether the issuer had adequate controls in place over its financial reporting system.[64]

We believe that an error that is material to previously issued financial statements constitutes ''material noncompliance'' by the issuer with a financial reporting requirement under the securities laws, as contemplated by Section 10D. Accordingly, proposed Rule 10D–1 would provide that issuers adopt and comply with a written policy providing that in the event the issuer is required to prepare a restatement [65] to correct an error [66] that is material to previously issued financial statements,[67] the obligation to prepare the restatement would trigger application of the recovery policy.[68] In connection with this, proposed Rule 10D–1 would define an accounting restatement as 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.[69] We do not propose to describe any type or characteristic of an error that would be considered material for purposes of the listing standards required by proposed Rule 10D–1 because materiality is a determination that must be analyzed in the context of particular facts and circumstances. Moreover, materiality has received extensive and comprehensive judicial and regulatory attention.[70] We note 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.

As indicated in the accounting standards, the following types of changes to an issuer's financial statements do not represent error corrections, and therefore would not trigger application of the issuer's recovery policy under the proposed listing standards:

- Retrospective application of a change in accounting principle; [71]
- Retrospective revision to reportable segment information due to a change in

[57] Senate Report at 135.

[58] *See* letters from Frederic W. Cook & Co., Inc., Towers Watson, Baker, Donelson, Bearman, Caldwell & Berkowitz, PC and Compensia, Inc.

[59] *See* letter from Compensia, Inc.

[60] *See* letter from Compensia, Inc.

[61] *See* letters from Baker, Donelson, Bearman, Caldwell & Berkowitz, PC and Davis Polk & Wardwell LLP.

[62] *See* letters from Towers Watson and Baker, Donelson, Bearman, Caldwell & Berkowitz, PC.

[63] *See* letters from Center on Executive Compensation, Frederic W. Cook & Co., Inc. and Protective Life Corporation.

[64] *See* letter from Towers Watson.

[65] Under U.S. Generally Accepted Accounting Principles (''GAAP''), a restatement is ''the process of revising previously issued financial statements to reflect the correction of an error in those financial statements.'' *See* FASB ASC Topic 250, *Accounting Changes and Error Corrections* (formerly SFAS No. 154, *Accounting Changes and Error Corrections*) (''ASC Topic 250''). Under International Financial Reporting Standards as issued by the International Accounting Standards Board (''IFRS''), a retrospective restatement is ''correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.'' *See* IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors,* paragraph 5.

[66] Under GAAP, an error in previously issued financial statements 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.'' *See* ASC Topic 250. Under IFRS, prior period errors are ''omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that: (a) Was available when financial statements for those periods were authorised for issue; and (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.'' *See* IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors,* paragraph 5.

[67] When we refer to financial statements, we mean the statement of financial position (balance sheet), income statement, statement of comprehensive income, statement of cash flows, statement of owners' equity, and accompanying footnotes, as required by Commission regulations. When we refer to financial statements for registered investment companies and business development companies, we mean the statement of assets and liabilities (balance sheet) or statement of net assets, statement of operations, statement of changes in net assets, statement of cash flows, schedules required by Rule 6–10 of Regulation S–X, financial highlights, and accompanying footnotes, as required by Commission regulations.

[68] Proposed Rule 10D–1(c)(5).

[69] Proposed Rule 10D–1(c)(1)

[70] *See, e.g., TSC Industries, Inc.* v. *Northway,* 426 U.S. 438 (1976); *Basic* v. *Levinson,* 485 U.S. 224 (1988).

[71] A change in accounting principle is ''[a] change from one generally accepted accounting principle to another generally accepted accounting principle when there are two or more generally accepted accounting principles that apply or when the accounting principle formerly used is no longer generally accepted. A change in the method of applying an accounting principle also is considered a change in accounting principle.'' *See* ASC Topic 250. IAS 8 has similar guidance. A change from an accounting principle that is not generally accepted to one that is generally accepted, however, would be a correction of an error.

the structure of an issuer's internal organization;[72]

- Retrospective reclassification due to a discontinued operation;[73]
- Retrospective application of a change in reporting entity, such as from a reorganization of entities under common control;[74]
- Retrospective adjustment to provisional amounts in connection with a prior business combination;[75] and
- Retrospective revision for stock splits.

Request for Comment

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?[76] 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?

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?

14. Should any revision to previously issued financial statements that results in a reduction in incentive-based compensation received by an executive officer always trigger application of an issuer's recovery policy under the proposed listing standards? Why or why not?

15. As noted above, certain changes to the financial statements would not trigger recovery because they do not represent error corrections under the accounting standards. Are there any other types of changes to an issuer's financial statements that should not be deemed to trigger application of the issuer's recovery policy?

16. Should the proposed listing standards contain any anti-evasion language regarding the circumstances in which recovery would be triggered? If so, what should the language provide?

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

Section 10D(b)(2) requires exchanges and associations to adopt listing standards that require issuers to adopt and comply with policies that require the recovery of excess incentive-based compensation ''during the 3-year period preceding the date on which the issuer is required to prepare an accounting restatement.'' Section 10D does not specify when a listed issuer is ''required to prepare an accounting restatement'' for purposes of this recovery provision.

Several commenters requested clarification on how to determine the date on which the issuer is ''required to prepare an accounting restatement'' and provided suggestions in this regard.[77] One commenter asked whether a restatement would be ''required'' for purposes of Section 10D as of the date the financial statements are stated incorrectly.[78] Another commenter expressed the view that the date of the erroneous statement should be the date on which a new statement must be prepared.[79] Other commenters recommended that the recovery trigger should be the date the issuer files an accounting restatement due to the issuer's material noncompliance with a financial reporting requirement under the securities laws.[80] A different commenter suggested using the date the decision to undertake the restatement is made, providing as examples the date an issuer's board of directors authorizes the preparation of an accounting restatement or the date a court or regulatory authority orders or requires an issuer to prepare an accounting restatement.[81] Another commenter recommended that the issuer be deemed ''required to prepare an accounting restatement'' when a Current Report on Form 8–K is filed disclosing non-reliance on the issuer's financial statements, or, if no Form 8–K is required, the date that either the board of directors or management determines that a restatement is required.[82]

We considered the alternatives identified by commenters for when an issuer is ''required to prepare an accounting restatement'' for purposes of the proposed listing standards, and are concerned that some of these alternatives would not operate effectively with the three-year look-back period for recovery prescribed by Section 10D. While the issuer has an obligation to file materially complete and accurate financial statements, which could support using the date the erroneous financial statements were filed as the triggering date for Section 10D, we believe this approach would not fully effectuate Section 10D's purpose. If the date of filing of the erroneous financial statements were used as the starting point for the look-back period, recovery would not apply to any incentive-based compensation received after that date, even when the amount was affected by the erroneous financial statements. For example, if 2014 net income was materially misstated, and a 2014–2016 long-term incentive plan had a performance measure of three-year cumulative net income, a look-back period that covered only the three years before the erroneous filing would not capture the compensation earned under that plan. While the date of the erroneous filing is easily discernible, using this date may result in listed issuers recovering only incentive-based compensation that was received during the fiscal year preceding the filing date of the financial statements that included the subsequently restated financial reporting measure. We believe this result would be inconsistent with the three-year look-back period that the statute specifies.

We also considered using the date the issuer files the accounting restatement for triggering the three-year look-back period. However, we believe this approach also would not appropriately implement Section 10D because the issuer necessarily would have been required to prepare an accounting restatement at some point before it actually filed the restatement.[83] Moreover, an issuer might improperly delay filing a restatement after determining that restatement was necessary, and by doing so could affect

[72] If an issuer changes the structure of its internal organization in a manner that causes the composition of its reportable segments to change, the corresponding information for earlier periods, including interim periods, should be revised unless it is impracticable to do so. *See* ASC Topic 280–10–50–34. IFRS 8 has similar guidance.

[73] *See* ASC Topic 205–20. IFRS 5 has similar guidance.

[74] *See* ASC Topic 250–10–45–21. IFRS does not have specific guidance addressing this reporting matter.

[75] *See* ASC Topic 805–10–25–13. IFRS 3 has similar guidance.

[76] *See* n.65, above.

[77] *See* letters from Center on Executive Compensation, Compensia, Inc., Davis Polk & Wardwell LLP, Meridian Compensation Partners, LLC, and Towers Watson.

[78] *See* letter from Towers Watson.

[79] *See* AFL–CIO Joint Letter.

[80] *See* letters from Center on Executive Compensation and Protective Life Corporation.

[81] *See* letter from Compensia, Inc.

[82] *See* letter from Davis Polk & Wardwell LLP.

[83] As noted in Section II.C.2.b, below, the three-year look-back period is not meant to limit or designate the reporting periods for which an accounting restatement is required, or to limit which restated financial statements may be filed with the Commission.

the amounts of compensation subject to recovery.

In considering how best to craft a trigger for recovery under the proposed listing standards, we have sought to define the date on which an accounting restatement is required in a way that provides reasonable certainty for issuers, shareholders and exchanges while not permitting issuers to avoid recovery when a material error has occurred. To that end, we are proposing a definition that would be triggered by the occurrence of certain issuer or third-party determinations about the need for a restatement. Specifically, 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.[84]

A note to the proposed rule would indicate that the first proposed date generally is expected to coincide with the occurrence of the event described in Item 4.02(a) of Exchange Act Form 8–K, although neither proposed date is predicated on a Form 8–K having been filed.[85] For the first proposed date to occur, the issuer merely needs to have concluded that previously issued financial statements contain a material error, which we expect may occur before the precise amount of the error has been determined. While we recognize that listed issuers must apply judgment before concluding that previously issued financial statements contain a material error, we believe this judgment should be applied on an objective basis, which is when a reasonable issuer, based on the facts available, would have concluded that the previously issued financial statements contain a material error. In this regard, while not dispositive, we believe that an issuer would have to consider carefully any notice received from its independent auditor that previously issued financial statements contain a material error.

We recognize that the second proposed date on which an issuer would be required to prepare a restatement for purposes of Section 10D may occur earlier than the board's determination if a court or other legally authorized body, such as a regulator, directs the issuer to restate.

We believe a definition that incorporates the proposed triggering events rather than leaving the determination solely to the discretion of the issuer would better realize the objectives of Section 10D while providing clarity about when a recovery policy, and specifically the determination of the three-year look-back period, will be triggered for purposes of the proposed listing standards. In this regard, we note that the proposed rule also states that an issuer's obligation to recover excess incentive-based compensation is not dependent on if or when the restated financial statements are filed. Further, we note that issuers that knowingly, recklessly or negligently misreport materially false or misleading financial information would be subject to liability under existing antifraud provisions.[86]

Request for Comment

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 determine when recovery would be triggered for purposes of compliance with the proposed listing standards? Are there additional triggers we should consider including?

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?

19. Are there other means of defining the date on which an issuer is required to prepare an accounting restatement that would provide clear benchmarks that do not inject subjectivity into when recovery would be triggered? If so, how should the date on which the issuer is required to prepare a restatement be defined?

C. Application of Recovery Policy

1. Executive Officers Subject to Recovery Policy

Section 10D(b)(2) requires exchanges and associations to adopt listing standards that require issuers to adopt and comply with policies that provide for recovery of excess incentive-based compensation from ''any current or former executive officer of the issuer who received incentive-based compensation.'' Section 10D does not define ''executive officer'' for purposes of the recovery policy.[87]

Several commenters requested guidance on the definition of executive officer.[88] One commenter[89] indicated that the Section 10D's reference to executive officer appears to use the executive officer definition in Exchange Act Rule 3b–7.[90] Another commenter[91] questioned whether the recovery policy would cover officers subject to Exchange Act Section 16[92] or only the

[84] Proposed Rule 10D–1(c)(2).

[85] Note to proposed Rule 10D–1(c)(2). For example, if a listed issuer files an Item 4.02(b) Form 8–K because it is advised by, or receives notice from, its independent accountant that disclosure should be made or action should be taken to prevent future reliance on a previously issued audit report or completed interim review related to previously issued financial statements that contain a material error, the triggering event for the recovery policy occurs when the listed issuer decides to restate its financial statements even if it subsequently neglects to file an Item 4.02(a) Form 8–K to report that decision.

[86] *See* Securities Act Section 17(a) [15 U.S.C. 77q(a)], Exchange Act Section 10(b) [15 U.S.C. 78j(b)] and Exchange Act Rule 10b–5 [17 CFR 240.10b–5].

[87] The Senate Committee on Banking, Housing, and Urban Affairs noted that ''[t]his policy is required to apply to executive officers, a very limited number of employees, and is not required to apply to other employees.'' Senate Report at 136.

[88] *See* letters from Baker, Donelson, Bearman, Caldwell & Berkowitz, PC, Towers Watson and Robert E. Scully Jr.

[89] *See* letter from Towers Watson.

[90] Exchange Act Rule 3b–7 provides that ''[t]he term executive officer, when used with reference to a registrant, means its president, any vice president of the registrant in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy making function or any other person who performs similar policy making functions for the registrant.'' Executive officers of subsidiaries may be deemed executive officers of the registrant if they perform such policy making functions for the registrant.'' 17 CFR 240.3b–7.

[91] *See* letter from Baker, Donelson, Bearman, Caldwell & Berkowitz, PC.

[92] 15 U.S.C. 78p. As defined in Exchange Act Rule 16a–1(f) [17 CFR 240.16a–1(f)], the term ''officer'' means ''an 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 (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer. Officers of the issuer's parent(s) or subsidiaries shall be deemed officers of the issuer if they perform such policy-making functions for the issuer.'' The rule also contains specific provisions with respect to limited partnerships and trusts, and a note providing that ''policy-making function'' is not intended to include policy making functions that are not

named executive officers.[93] Another specifically recommended using the Section 16 definition of ''officer,'' and stated that executive officers of subsidiaries should be included in the definition.[94] A different commenter requested guidance regarding how the recovery policy should apply to persons who are executive officers during only a portion of the recovery period.[95]

We believe that Section 10D's mandatory recovery policy was intended to apply, at a minimum, to all executive officers of the issuer, rather than a more limited category such as the named executive officers for whom executive compensation disclosure is required under Item 402 of Regulation S–K. The Senate Report accompanying the statute indicates that ''[t]his policy is required to apply to executive officers[.]'' [96] Moreover, we believe applying the recovery policy to all executive officers would more effectively realize the statutory goal of Section 10D because officers with policy making functions and important roles in the preparation of financial statements set the tone for and manage the issuer. In this regard, we do not believe that a listed issuer should be unable to recover unearned compensation from an executive officer simply because he or she was not one of the individuals identified for purposes of Item 402's disclosure requirements.

The proposed listing standards would include a definition of ''executive officer'' in Rule 10D–1 that is modeled on the definition of ''officer'' in Rule 16a–1(f). For purposes of Section 10D, an ''executive officer'' would be 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 (such as sales administration or finance), 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 parents or subsidiaries would be deemed executive officers of the issuer if they perform such policy making functions for the issuer.[97]

In particular, the proposed definition would expressly include the principal financial officer and the principal accounting officer (or if there is no such accounting officer, the controller) among the officers specified. We believe that their responsibility for financial information justifies their inclusion in the definition of ''executive officer'' for this purpose, just as these officers were specifically included in the Rule 16a–1(f) definition of ''officer.[98] Although the compensation recovery provisions of Section 10D apply without regard to an executive officer's responsibility for preparing the issuer's financial statements, we believe that it is clearly appropriate for officers with an important role in financial reporting to be subject to the recovery policy. The proposed definition, like Rule 16a–1(f), provides that executive officers of the issuer's parents or subsidiaries may be deemed executive officers of the issuer if they perform policy making functions for the issuer. As is the case for Section 16 officer determination, if pursuant to Item 401(b) of Regulation S–K the issuer identifies a person as an ''executive officer,'' it would be presumed that the board of directors has made that judgment and the persons so identified are executive officers for purposes of proposed Rule 10D–1.[99]

Section 10D(b)(2) calls for the recovery policy to apply to ''any current or former executive officer of the issuer who received incentive-based compensation [during the three-year look-back period].'' We believe that the statute was designed to require recovery of excess incentive-based compensation provided for service as an executive officer. Accordingly, the rule and rule amendments we propose would require recovery of excess incentive-based compensation received by an individual who served as an executive officer of the listed issuer at any time during the performance period for that incentive-based compensation.[100] This would include incentive-based compensation derived from an award authorized before the individual becomes an executive officer, and inducement awards granted in new hire situations, as long as the individual served as an executive officer of the listed issuer at any time during the award's performance period. As proposed, recovery would not apply to an individual who is an executive officer at the time recovery is required if that individual had not been an executive officer at any time during the performance period for the incentive-based compensation subject to recovery.

Request for Comment

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?

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?

22. Are there any other officers who should be included in the group of executive officers subject to the issuer's recovery policy, but who may not fall within the proposed definition? Is the definition of executive officer appropriate? If not, how else should executive officer be defined?

23. Alternatively, is the proposed definition of ''executive officer'' too broad? Should we instead limit the recovery policy to ''named executive officers,'' as defined in Items 402(a)(3) and 402(m)(2) of Regulation S–K or otherwise define a more narrow set of officers subject to recovery?

24. Will the scope of the term ''executive officer'' for purposes of Section 10D affect issuers' practices in

significant and that persons identified as ''executive officers'' pursuant to Item 401(b) of Regulation S–K [17 CFR 229.401(b)] are presumed to be officers for purposes of Section 16, as are other persons enumerated in Rule 16a–1(f) but not in Item 401(b). 15 U.S.C. 78p.

[93] *See* Item 402(a)(3) of Regulation S–K. For smaller reporting companies and emerging growth companies, named executive officers include the following: all individuals serving as the issuer's principal executive officer or acting in similar capacities during the last completed fiscal year, regardless of compensation level; the issuer's two most highly compensated executive officers other than the principal executive officer who were serving as executive officers at the end of the last completed fiscal year; and up to two additional individuals for whom disclosure would have been provided based on highest compensation but for the fact that the individual was not serving as an executive officer of the issuer at the end of the last completed fiscal year. *See* Item 402(m)(2) of Regulation S–K and Section 102(c) of the Jumpstart Our Business Startups Act (''JOBS Act'').

[94] *See* AFL–CIO Joint Letter.

[95] *See* letter from Baker, Donelson, Bearman, Caldwell & Berkowitz, PC.

[96] *See* Senate Report.

[97] Proposed Rule 10D–1(c)(3), which also would specify who would be executive officers if the issuer is a limited partnership or trust.

[98] 17 CFR 240.16a–1(f). In proposing their inclusion in the Rule 16a–1(f) definition of ''officer,'' the Commission noted that principal financial officers and principal accounting officers are required to sign an issuer's Securities Act registration statements and Exchange Act annual reports on Form 10–K. Release No. 34–27148 (Aug. 18, 1989) [54 FR 35667] at n. 31. Subsequently, Section 302 of SOX required the principal financial officer, as well as the principal executive officer, to certify the information contained in each annual or quarterly report filed under Section 13(a) or 15(d) of the Exchange, and the effectiveness of the issuer's internal controls. Listed companies could, of course, adopt policies that applied to a larger group of employees so long as the policy at a minimum applied to executive officers.

[99] *See* proposed Note to Rule10D–1(c)(3), modeled on the *Note* to Rule 16a–1(f).

[100] Proposed Rule 10D–1(b)(1)(i)(B).

identifying executive officers for other purposes? If so, how, and what if anything should we do to address that? Are there other means of simplifying the identification of ''executive officers'' for purposes of Rule 10D–1 that would promote consistency with identifying executive officers for other purposes, such as Item 401(b) of Regulation S–K? Is there another, more appropriate definition?

25. Is it consistent with the purposes of Section 10D to apply recovery to any incentive-based compensation earned during the three completed fiscal years immediately preceding the date that the issuer is required to prepare a restatement if that person served as an executive officer at any time during the performance period? Alternatively, should an individual be subject to recovery only for incentive-based compensation earned during the portion of the performance period during which the individual was serving as an executive officer? Should an individual who is an executive officer at the time recovery is required 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? If a different standard should govern the circumstances when an executive officer or former executive officer is subject to recovery, what should that standard be, and why should it apply?

2. Incentive-Based Compensation

a. Incentive-Based Compensation Subject to Recovery Policy

Section 10D(b)(2) requires exchanges and associations to adopt listing standards that require issuers to adopt and comply with recovery policies that apply to ''incentive-based compensation (including stock options awarded as compensation)'' that is received, based on the erroneous data, in ''excess of what would have been paid to the executive officer under the accounting restatement.'' Implicit in these statutory requirements is that the amount of such compensation received in the three-year look-back period would have been less if the financial statements originally had been prepared as later restated.

Several commenters recommended that the Commission clarify the types of compensation to which the listing standards' recovery policy would apply.[101] To that end, some commenters suggested potential standards that focused on the compensation being based on or related to publicly reported financial statements.[102] For example, one commenter stated that any form of compensation that is contingent upon the achievement of one or more pre-determined and objective performance goals ''that expressly relate to and are derived from one or more financial or stock price metric set forth in an issuer's financial statements filed with the Commission'' should be incentive-based compensation for purposes of Section 10D.[103] In some cases, commenters suggested we look to the existing definitions of ''incentive plan,'' ''equity incentive plan award'' and ''non-equity incentive plan award'' in Item 402(a)(6)(iii) of Regulation S–K in defining incentive-based compensation subject to recovery.[104]

To identify compensation that is awarded or vests based on financial performance measures, some commenters[105] provided various examples of financial information required to be reported under the securities laws, such as revenue, net income and earnings per share, and examples of related non-GAAP measures, such as EBITDA.[106] Commenters also recommended that awards based solely on satisfaction of non-financial measures—for example, operational measures such as market share and customer satisfaction, subjective measures such as leadership, and strategic measures such as consummation of a merger—should not be subject to an issuer's recovery policy.[107] Generally, commenters who specifically addressed stock price and total shareholder return[108] measures recommended excluding them from recovery policies,[109] or expressed the view that any connection between the erroneous data relating to an accounting restatement and the fluctuating value of the issuer's stock would be tangential and speculative.[110]

One commenter who addressed the statute's inclusion of ''stock options awarded as compensation'' questioned whether recovery should apply to the extent the enhancement in an award's value is solely attributable to increases in the fair market value of the underlying shares.[111] Other commenters recommended excluding from recovery equity awards that are not granted upon achievement of one or more pre-determined and objective financial metrics, and that vest solely upon the passage of time, continued service or satisfaction of non-financial metrics.[112]

Commenters also raised questions whether other forms of compensation, such as discretionary bonuses, future benefits under supplemental retirement benefit plans calculated based on incentive compensation awards and investment returns on incentive-based compensation deferred pursuant to deferred compensation plans, would be incentive-based compensation subject to recovery.[113] In particular, some commenters requested guidance concerning bonuses paid pursuant to ''pool plans,'' where achievement of financial performance measures establishes the overall size of the bonus pool, but discretion is exercised in determining the amount of individual bonuses.[114]

In considering how best to define incentive-based compensation for purposes of the proposed rule,[115] we have considered the statutory language of Section 10D, the views of commenters, and the administrability of any mandatory recovery policy that encompasses such compensation. Rather than identifying each type or form of compensation to which a recovery policy required under the listing standards would apply, for purposes of proposed Rule 10D–1 we propose to define ''incentive-based compensation'' in a principles-based manner, which we believe would enable the rule and rule amendments to operate effectively as new forms of compensation and new measures of

[101] *See, e.g.,* letters from ABA Business Law Section, American Benefits Council, Center on Executive Compensation, Meridian Compensation Partners, LLC, Protective Life Corporation, Robert E. Scully Jr, and Society of Corporate Secretaries and Governance Professionals.

[102] *See, e.g.,* letters from ABA Business Law Section, American Benefits Council, Center on Executive Compensation, David Polk, and Meridian Compensation Partners, LLC.

[103] *See* letter from Meridian Compensation Partners, LLC.

[104] *See* letters from ABA Business Law Section and David Polk.

[105] *See, e.g.,* letters from Center on Executive Compensation, Meridian Compensation Partners, LLC and Protective Life Corporation.

[106] Earnings before interest, taxes, depreciation and amortization.

[107] *See, e.g.,* letters from Center on Executive Compensation, Meridian Compensation Partners, LLC, Protective Life Corporation, and Society of Corporate Secretaries and Governance Professionals.

[108] ''Total shareholder return'' or ''TSR'' is a measure based on the change in stock price plus dividends over a period of time.

[109] *See* letters from Center on Executive Compensation and Protective Life Corporation.

[110] *See* letter from American Benefits Council.

[111] *See* letter from American Benefits Council.

[112] *See* letters from Center on Executive Compensation, Compensia, Meridian Compensation Partners, LLC and Protective Life Corporation.

[113] *See, e.g.,* letter from Robert E. Scully, Jr.

[114] *See* letters from Center on Executive Compensation and Protective Life Corporation.

[115] The proposed definition would be applicable only to recovery of incentive-based compensation under proposed Rule 10D–1, and would not apply to the recovery of incentive-based compensation pursuant to SOX Section 304.

performance upon which compensation is based are developed. As proposed, ''incentive-based compensation'' would be defined as ''any compensation that is granted, earned or vested based wholly or in part upon the attainment of any financial reporting measure.'' [116]

The proposed definition would further provide that ''financial reporting measures'' are measures that are determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements,[117] any measures derived wholly or in part from such financial information,[118] and stock price and total shareholder return. Such measures would be encompassed by the definition of financial reporting measures whether or not included in a filing with the Commission,[119] and may be presented outside the financial statements, such as in Management's Discussion and Analysis of Financial Conditions and Results of Operations (''MD&A'') [120] or the performance graph.[121] Accordingly, examples of financial reporting measures would include, but would not be limited to, the following accounting-based measures (including measures derived therefrom):

- Revenues;
- Net income;
- Operating income;
- Profitability of one or more reportable segments; [122]
- Financial ratios (*e.g.,* accounts receivable turnover and inventory turnover rates);
- Net assets or net asset value per share (for registered investment companies and business development companies that are subject to the rule);
- EBITDA; [123]
- Funds from operations (''FFO'') [124] and adjusted funds from operations (''AFFO'');
- Liquidity measures (*e.g.,* working capital, operating cash flow);
- Return measures (*e.g.,* return on invested capital, return on assets);
- Earnings measures (*e.g.,* earnings per share);
- Sales per square foot or same store sales, where sales is subject to an accounting restatement;
- Revenue per user, or average revenue per user, where revenue is subject to an accounting restatement;
- Cost per employee, where cost is subject to an accounting restatement;
- Any of such financial reporting measures relative to a peer group, where the issuer's financial reporting measure is subject to an accounting restatement; and
- Tax basis income.

In addition to measures that are derived from the financial statements, the proposed definition of financial reporting measures would include performance measures based on stock price or total shareholder return. Section 10D(b) requires disclosure of an issuer's policy with respect to ''incentive-based compensation that is based on financial information required to be reported under the securities laws'' and recovery of compensation awarded ''based on the erroneous data.'' Although the phrase ''financial information required to be reported under the securities laws'' might be interpreted as applying only to accounting-based metrics, we believe that it also includes performance measures such as stock price and total shareholder return that are affected by accounting-related information and that are subject to our disclosure requirements.[125] Further, Congress' direction to include compensation that is *based on* financial information and to recover compensation *based on* the erroneous accounting data suggests that we should include incentive compensation tied to measures such as stock price and total shareholder return to the extent that improper accounting affects such measures, and in turn results in excess compensation. We also recognize that total shareholder return is a frequently used performance metric for executive compensation,[126] and that excluding it might not promote the goals we believe Congress intended. Moreover, we are concerned that not including TSR could incentivize issuers to alter their executive compensation arrangements in ways that would avoid application of the mandatory recovery policy and result in less efficient incentive alignment.[127]

In proposing that the statutory language should be interpreted to encompass incentive-based compensation tied to stock price and total shareholder return, as well as accounting-based metrics, we have considered potential administrative burdens that could be imposed on issuers in determining the amount of compensation to be recovered. In some cases, issuers may need to engage in complex analyses that require significant technical expertise and specialized knowledge, and may involve substantial exercise of judgment in order to determine the stock price impact of a material restatement. Due to the presence of confounding factors, it sometimes may be difficult to establish the relationship between an accounting error and the stock price. We recognize these potential challenges and, as discussed more fully below,[128] are proposing that issuers be permitted to use reasonable estimates when determining the impact of a restatement on stock price and total shareholder return and to require them to disclose the estimates.[129] We believe that being able to use reasonable estimates to assess the effect of the accounting restatement on these performance measures in determining the amount of erroneously awarded compensation should help to mitigate these potential difficulties.

While the definition we are proposing is intended to be applied broadly and flexibly, it does not encompass all forms

[116] *See* proposed Rule 10D–1(c)(4). ''In part,'' is included in the definition to clarify that incentive-based compensation need not be based solely upon attainment of a financial reporting measure. An example of compensation that is based in part upon the attainment of a financial reporting measure would include an award in which 60 percent of the target amount is earned if a certain revenue level is achieved, and 40 percent of the target amount is earned if a certain number of new stores are opened. Similarly, an award for which the amount earned is based on attainment of a financial reporting measure but is subject to subsequent discretion by the compensation committee to either increase or decrease the amount would be based in part upon attainment of the financial reporting measure.

[117] For foreign private issuers whose financial statements are based upon a comprehensive body of accounting principles other than GAAP or IFRS, the restatement would relate to amounts reported using such other accounting principles but not the reconciliation to GAAP. We would not consider the reconciliation to GAAP to be within the meaning of financial reporting measures for purposes of this proposed rule.

[118] The proposed definition is broader than a ''non-GAAP financial measure'' for purposes of Exchange Act Regulation G [17 CFR 244.100 *et seq.*] and Item 10 of Regulation S–K [17 CFR 229.10].

[119] For example, same store sales or regional sales volume may not be disclosed in a filing with the Commission, but nevertheless could be affected by an accounting restatement for revenue recognition.

[120] 17 CFR 229.303. *See also* Item 5, Form 20–F. Examples of this could be accounts receivable turnover, EBITDA, or sales per square foot.

[121] 17 CFR 229.201(e).

[122] As disclosed in a financial statement footnote. *See* ASC Topic 280.

[123] Earnings before interest, taxes, depreciation and amortization.

[124] FFO is a non-GAAP financial measure commonly used in the real estate industry.

[125] In this regard, we note that Item 201 of Regulation S–K requires issuers with common equity the principal market for which is an exchange, to disclose the high and low sales prices ''for each full quarterly period within the two most recent fiscal years and any subsequent interim period for which financial statements are included . . . .'' In addition, Item 201(e) of Regulation S–K requires issuers that are not smaller reporting companies to disclose stock price information and a performance graph comparing the company's cumulative total shareholder return with a performance indicator of the overall stock market and either a published industry index or company-determined peer comparison.

[126] *See* Section III, below.

[127] *See* Section III, below.

[128] *See* Section II.C.3.a, below.

[129] *See* Section II.D.1, below.

of incentive compensation.[130] An incentive plan award that is granted, earned or vested based solely upon the occurrence of certain non-financial events, such as opening a specified number of stores, obtaining regulatory approval of a product, consummating a merger or divestiture, completing a restructuring plan or financing transaction, would not be ''incentive-based compensation'' because these measures of performance are not financial reporting measures. Although these non-financial metrics are not included in the proposed definition, we are soliciting comment below on whether the definition of ''incentive-based compensation'' should include additional performance measures.

The statute further specifies that incentive-based compensation to which recovery should apply under the recovery policy required by the listing standard ''includ[es] stock options awarded as compensation.'' Accordingly, as proposed, ''incentive-based compensation'' would include options and other equity awards whose grant or vesting is based wholly or in part upon the attainment of any measure based upon or derived from financial reporting measures.[131] Applying the proposed Rule 10D–1 definition, compensation that would be subject to the recovery policy required by the proposed listing standards would include, but not be limited to:

- Non-equity incentive plan awards that are earned based wholly or in part on satisfying a financial reporting measure performance goal;
- Bonuses paid from a ''bonus pool,'' the size of which is determined based wholly or in part on satisfying a financial reporting measure performance goal;
- Restricted stock, restricted stock units (''RSUs''), performance share units (''PSUs''), stock options, and stock appreciation rights (''SARs'') that are granted or become vested based wholly or in part on satisfying a financial reporting measure performance goal; and
- Proceeds received upon the sale of shares acquired through an incentive plan that were granted or vested based wholly or in part on satisfying a financial reporting measure performance goal.

Examples of compensation that would *not* be ''incentive-based compensation'' for this purpose would include, but not be limited to:

- Salaries;[132]
- Bonuses paid solely at the discretion of the compensation committee or board that are not paid from a ''bonus pool,'' the size of which is determined based wholly or in part on satisfying a financial reporting measure performance goal;
- Bonuses paid solely upon satisfying one or more subjective standards (*e.g.,* demonstrated leadership) and/or completion of a specified employment period;
- Non-equity incentive plan awards earned solely upon satisfying one or more strategic measures (*e.g.,* consummating a merger or divestiture), or operational measures (*e.g.,* opening a specified number of stores, completion of a project, increase in market share); and
- Equity awards for which the grant is not contingent upon achieving any financial reporting measure performance goal and vesting is contingent solely upon completion of a specified employment period and/or attaining one or more non-financial reporting measures.

Request for Comment

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.

27. Is the proposed definition of ''incentive-based compensation'' the best means to capture all forms of compensation that could be subject to reduction if recalculated based on an accounting restatement? If not, please explain what other forms of compensation, which would not be covered by the proposed definition, should be covered.

28. Are there circumstances in which compensation that is received upon completion of a specified employment period or upon the attainment of any other goal that is not covered by our proposed definition should be considered incentive-based compensation subject to recovery? Why or why not? If so, how would an issuer calculate the recoverable amounts in the event of an accounting restatement? Are there any other measures of compensation that should be included in the definition of incentive-based compensation? If so, which ones and why?

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?

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

[130] In this regard we note that the proposed definition of ''incentive-based compensation'' is narrower in scope than the definition of ''incentive plan,'' in Item 402(a)(6)(iii) of Regulation S–K, which is ''any plan providing compensation intended to serve as an incentive for performance to occur over a specified period, whether such performance is measured by reference to financial performance of the registrant or an affiliate, the registrant's stock price, or any other performance measure.'' Item 402(a)(6)(iii) of Regulation S–K [17 CFR 229.402(a)(6)(iii)]. The proposed Rule 10D–1 definition would not include ''other performance measures'' in light of Section 10D's reference to incentive-based compensation based on financial information required to be reported under the federal securities laws.

[131] This would be the standard for purposes of proposed Rule 10D–1 even though time-vested stock options are generally considered ''performance-based'' for purposes of exclusion from the Internal Revenue Code Section 162(m) $1 million cap on tax-deductible executive compensation if the amount of compensation attributable to the options is based solely on an increase in company stock price, assuming the exercise price is no less than fair market value of the underlying stock on the date of grant. *See* 26 CFR 1.162–27(e)(2)(vi).

[132] However, to the extent that an executive officer receives a salary increase earned wholly or in part based on the attainment of a financial reporting measure, such a salary increase would be subject to recovery as a non-equity incentive plan award for purposes of proposed Rule 10D–1.

attainment of a financial reporting measure''? If not, why not?

31. Should the proposed rule or listing standards contain any anti-evasion language that would treat as incentive-based compensation amounts received purportedly based on one or more subjective standards but that are in fact based on financial information metrics, total shareholder return or stock price performance? If so, what should the language provide?

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.

33. Regarding the statutory provision that incentive-based compensation subject to recovery ''includ[es] stock options awarded as compensation,'' does the proposed definition provide a basis by which issuers can identify equity awards that would be covered? If not, please explain why not. If all options should be subject to recovery, how should the amount subject to recovery following an accounting restatement be computed for time-vested options that are not granted based on satisfaction of a financial reporting measure performance goal?

34. Regarding bonuses granted from a ''bonus pool,'' the size of which is based wholly or in part upon satisfying a financial reporting measure performance goal, does the proposed definition properly subject this form of compensation to recovery? If not, how should we treat such compensation for purposes of Rule 10D–1?

35. Is further guidance needed as to how the proposed definition would apply to forms of compensation that may be paid out on a deferred basis, such as employee or employer contributions of incentive-based compensation to nonqualified deferred compensation plans and earnings thereon, and future retirement benefits payable under pension plans, such as supplemental retirement benefit plans, that are calculated based on incentive-based compensation? [133] If so, what further guidance should we provide?

b. Time Period Covered by Recovery Policy

Section 10D(b)(2) requires exchanges and associations to adopt listing standards that require issuers to adopt and comply with recovery policies that apply to excess incentive-based compensation received ''during the three-year period preceding the date on which the issuer is required to prepare an accounting restatement'' but does not otherwise specify how this three –year look-back period should be measured. Commenters recommended that the listing standards address this point.[134] One commenter suggested that it be the three fiscal years preceding the date that a Form 8–K is filed disclosing non-reliance on the issuer's financial statements, or, if no Form 8–K is required, preceding the date that either the board of directors or management makes a determination that a restatement is required.[135]

Under proposed Rule 10D–1, the three-year look-back period for the recovery policy required by the listing standards would be the three completed fiscal years immediately preceding the date the issuer is required to prepare an accounting restatement.[136] We believe that basing the look-back period on fiscal years, rather than a preceding 36-month period, is consistent with issuers' general practice of making compensation decisions and awards on a fiscal year basis. Using the proposed recovery period trigger, if a calendar year issuer concludes in November 2018 that a restatement of previously issued financial statements is required and files the restated financial statements in January 2019, the recovery policy would apply to compensation received in 2015, 2016 and 2017. The three-year look-back period is not meant to alter the reporting periods for which an accounting restatement is required or for which restated financial statements are to be filed with the Commission.[137] Moreover, an issuer would not be able to delay or relieve itself from the obligation to recover erroneously awarded incentive-based compensation by delaying or failing to file restated financial statements.

In proposing Rule 10D–1, we considered other approaches, such as a recovery policy that requires issuers to recover incentive-based compensation received during any period of three consecutive years preceding the date on which the issuer is required to prepare an accounting restatement so long as the incentive-based compensation was affected by the error. However, we do not believe that this approach is the most appropriate means to implement Section 10D because it would require additional judgments about which three years' compensation should be subject to recovery, making it less objective and harder for exchanges and listed issuers to apply uniformly.

In situations where an issuer has changed its fiscal year end during the three-year look-back period, we are proposing that the issuer must recover any excess incentive-based compensation received during the transition period occurring during, or immediately following, that three-year period in addition to any excess incentive-based compensation received during the three-year look-back period (*i.e.,* a total of four periods).[138] A transition period refers to the period between the closing date of the issuer's previous fiscal year end and the opening date of its new fiscal year.[139] For example, consider a situation in which, in late 2015, an issuer changes its fiscal closing date from June 30 to December 31, and subsequently reports on the transition period from July 1, 2015 to December 31, 2015. If the issuer's board of directors concludes in May 2017 that it will restate previously issued financial statements due to a material error, the look-back period would consist of the year ended June 30, 2014, the year ended June 30, 2015, the period from July 1, 2015 to December 31, 2015, and the year ended December 31, 2016. However, consistent with Rule 3–06(a) of Regulation S–X, a transition period of nine to 12 months would be considered a full year in applying the three-year look-back period requirement.

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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?

37. Should a different approach be used to determine the three-year look-back period for recovery? If so, how should the look-back period be determined, and why? For example, should an issuer be permitted to apply

[133] *See* Section II.C.3.a, below, addressing the computation of excess incentive-based compensation for these forms of compensation.

[134] *See* letters from Frederic W. Cook & Co., Inc., ABA Business Law Section and Baker, Donelson, Bearman, Caldwell & Berkowitz, PC.

[135] *See* letter from Davis Polk & Wardwell LLP.

[136] Proposed Rule 10D–1(b)(ii).

[137] For example, assume the three-year look-back period is 2016, 2017 and 2018, and incentive compensation received (as ''received'' would be defined in proposed Rule 10D–1(c)(6), discussed in Section II.C.2.c, below) in 2016 was earned by achieving a certain level of cumulative operating income for the two-year period from 2015 to 2016. In determining the amount of excess compensation received in 2016, the issuer would be required to prepare restated financial statements for 2015 and 2016 even if the issuer does not file one or both of those restated financial statements.

[138] Proposed Rule 10D–1(b)(1)(ii).

[139] 17 CFR 240.13a–10 and 17 CFR 240.15d–10

its recovery policy to any three-year period in which incentive-based compensation received by executive officers was affected by the accounting error?

38. Is the proposed approach regarding transition periods related to a change in fiscal year appropriate? If not, what alternative approach should we consider? Consistent with Rule 3–06(a) of Regulation S–X, should a transition period of nine to 12 months be considered a full year in satisfying the three-year look-back period requirement?

c. When Incentive-Based Compensation Is ''Received''

Section 10D does not specify when an executive officer should be deemed to have received incentive-based compensation for the recovery policy required under the applicable listing standards. One commenter asked the Commission to clarify whether an option or SAR is received when it is granted or when it is exercised or whether restricted stock, RSUs, other stock-based compensation and long-term cash incentives are received when granted, earned, vested or paid out.[140] Another commenter suggested that compensation be deemed received on the earlier of the date the compensation is paid to or earned by the executive officer, construing ''earned'' to mean when an executive officer obtains a non-forfeitable interest in a compensatory award.[141]

As proposed, incentive-based compensation would be deemed received for purposes of triggering the recovery policy under Section 10D in the fiscal period[142] during which the financial reporting measure specified in the incentive-based compensation award is attained, even if the payment or grant occurs after the end of that period.[143] Under this standard, the date of receipt would depend upon the terms of the award. If the grant of an award is based, either wholly or in part, on satisfaction of a financial reporting measure, the award would be deemed received in the fiscal period when that measure was satisfied. If an equity award vests upon satisfaction of a financial reporting measure, the award would be deemed received in the fiscal period when it vests. Similarly, a cash award earned upon satisfaction of a financial reporting measure would be deemed received in the fiscal period when that measure is satisfied.

A particular award may be subject to multiple conditions. We are not proposing that an executive officer must have satisfied all conditions to an award for the incentive-based compensation to be deemed received for purposes of triggering the recovery policy. For example, an issuer could grant an executive officer an RSU award in which the number of RSUs earned is determined at the end of the three-year incentive-based performance period (2015–2017), but the award is subject to service-based vesting for two more years (2018–2019). Although the executive officer does not have a non-forfeitable interest in the RSUs before expiration of the subsequent two-year service-based vesting period, the number of shares in which the RSUs ultimately will be paid will be established at the end of the three-year performance period. In light of Section 10D's purpose to require listed issuers to recover compensation that ''the executive would not have received if the accounting was done properly,''[144] we believe that in this circumstance the executive officer ''receives'' the compensation for purposes of triggering the recovery policy when the relevant financial reporting measure performance goal is attained, even if the executive officer has established only a contingent right to payment at that time. If the issuer's board of directors concludes in 2018 that the issuer will restate previously issued financial statements for 2015 through 2017 (the three-year performance period),[145] the recovery policy should apply to reduce the number of RSUs ultimately payable in stock, even though the executive has not yet satisfied the two-year service-based vesting condition to payment. In this example, if the executive officer were deemed not to receive the RSUs before obtaining a non-forfeitable interest in them, such a restatement of the financial statements that would reduce the number of RSUs ultimately payable in stock would not be subject to recovery because the incentive-based compensation would not have been received during the three-year look-back period. We do not believe such an outcome would appropriately implement the policy underlying Section 10D, because it would mean that the mere passage of time pursuant to a service-based vesting condition or a subsequent performance condition unrelated to a financial reporting measure[146] would preclude the issuer from recovering incentive-based compensation.

Ministerial acts or other conditions necessary to effect issuance or payment, such as calculating the amount earned or obtaining the board of directors' approval of payment, would not affect the determination of the date received. For example, for an equity award deemed received upon grant, receipt would occur in the fiscal year that the relevant financial reporting measure performance goal was satisfied, rather than a subsequent date on which the award was issued.[147] Similarly, a non-equity incentive plan award would be deemed received in the fiscal year that the executive earns the award based on satisfaction of the relevant financial reporting measure performance goal, rather than a subsequent date on which the award was paid.[148]

Under proposed Rule 10D–1, incentive-based compensation would be subject to the issuer's recovery policy to the extent that it is received while the issuer has a class of securities listed on an exchange or an association.[149] An award of incentive-based compensation granted to an executive officer before the issuer lists a class of securities would be subject to the recovery policy, so long as the incentive-based compensation was received by the executive officer while the issuer had a class of listed securities. Incentive-based compensation received by an executive officer before the issuer's securities become listed would not be subject to the recovery policy under our proposed

[140] *See* letter from Brian Foley & Company, Inc.

[141] *See* letter from Meridian Compensation Partners, LLC.

[142] Including a transition period for a change in fiscal year, if applicable.

[143] Proposed Rule 10D–1(c)(6).

[144] *See* Senate Report at 135.

[145] In this example, the three-year performance period coincides with the three-year look-back period covered by the recovery policy. *See* Section II.C.2.b. above regarding the three-year look-back period.

[146] For example, if the subsequent condition in the example above was not service-based vesting but instead called for the issuer to open 100 stores during 2018 and 2019, or required the executive to comply with a non-compete or non-solicitation covenant during those years.

[147] The fiscal year in which an incentive-based equity award is deemed received upon grant in some cases may be a fiscal year preceding the fiscal year in which the ASC Topic 718 grant date occurs and for which it is reported in the Summary Compensation Table and Grants of Plan-Based Awards Table because our requirements for reporting equity awards in the Summary Compensation Table do not utilize a ''performance year'' standard. *See Proxy Disclosure Enhancements,* Release No. 33–9089 (Dec. 16, 2009) [74 FR 68334] at Section II.A.2.c.

[148] This would be the same fiscal year for which the non-equity incentive plan award earnings are reported in the Summary Compensation Table, based on Instruction 1 to Item 402(c)(2)(vii), which provides: ''If the relevant performance measure is satisfied during the fiscal year (including for a single year in a plan with a multi-year performance measure), the earnings are reportable for that fiscal year, even if not payable until a later date, and are not reportable again in the fiscal year when amounts are paid to the named executive officer.''

[149] Proposed Rule 10D–1(b)(1)(i)(A).

rule. As proposed, an exchange would not be permitted to list an issuer that it has delisted or that has been delisted from another exchange for failing to comply with its recovery policy until the issuer comes into compliance with that policy.[150]

Request for Comment

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?

40. Should an executive officer be required to obtain a non-forfeitable entitlement to the incentive-based compensation to ''receive'' the compensation? Would such a requirement effectuate the purpose of Section 10D? Should the rule specifically address the treatment of awards subject to multiple vesting conditions, only some of which may be linked to financial reporting measures? If so, what would be the appropriate treatment of such rewards?

41. If following receipt, as proposed to be defined, an executive officer contributes incentive-based compensation to a nonqualified deferred compensation plan, how should deferral affect recovery? [151]

42. Should incentive-based compensation be subject to the issuer's recovery policy only to the extent that it is received while the issuer has a class of securities listed, as proposed? If not, please explain in what circumstances a different standard should apply and why. For example, if a company lists in 2017, and restates the three prior fiscal years in 2018, should its policy require recovery of incentive-based compensation received in 2015 or 2016?

3. Recovery Process

a. Determination of Excess Compensation

Section 10D(2)(b) requires exchanges and associations to adopt listing standards that require issuers to adopt and comply with recovery policies that apply to the amount of incentive-based compensation received ''in excess of what would have been paid to the executive officer under the accounting restatement.''

Commenters recommended that the Commission clarify how excess compensation subject to recovery should be determined.[152] One commenter suggested that the Commission establish a clear set of guidelines as to how issuers should calculate the recoverable amount under a variety of common arrangements, or alternatively, a clear set of principles to be used to make such calculations.[153] In some cases, commenters recommended specific ways to measure excess compensation for particular forms of incentive-based compensation. For example, for cash awards based upon the achievement of erroneous financial metrics, one commenter recommended that the excess incentive-based compensation should be the difference between the cash award that was granted and the cash award that should have been granted using the restated financial metric.[154]

Several commenters sought clarity regarding performance-based equity awards, with some recommending various methods to calculate the recoverable amount for different forms of these awards, taking into account such factors as whether an award is granted or vested based on attaining a financial statement metric, whether or not an option has been exercised, and whether the shares have been sold.[155]

Regarding bonuses paid from ''pool plans,'' two commenters questioned whether determination of the recoverable amount might depend on whether the board or compensation committee had exercised any discretion, either in determining whether to allocate the entire pool to bonus awards or in determining individual bonus amounts.[156] For example, commenters noted that if a restatement reduces the size of the bonus pool, but not below the aggregate amount that the board exercised discretion to pay out as bonuses, there would not appear to be any excess compensation to recover. Alternatively, if a restatement reduces the size of the bonus pool below the aggregate amount paid out, the commenters sought clarification whether each bonus paid would need to be ratably reduced, or if discretion could be exercised in allocating recovery of the excess amount among individual bonuses as long as the aggregate excess amount is recovered. Another commenter questioned, in general, whether the amount of compensation earned should be measured by reference to the target achieved, or the compensation actually provided after the compensation committee exercised discretion to either increase or decrease the amount.[157] A different commenter suggested that where incentive-based compensation is not determined based solely on formulaic measures, but also on qualitative measures, the same percentage recoverable from the formulaic portion based on the restatement also should be recovered from the portion based on qualitative measures.[158] Other commenters noted that executive officers would already have paid personal income taxes on incentive-based compensation they had received.[159]

We propose to define the recoverable amount as ''the amount of incentive-based compensation received by the executive officer or former executive officer that exceeds the amount of incentive-based compensation that otherwise would have been received had it been determined based on the accounting restatement.'' [160] Applying this definition, after an accounting restatement, the issuer would first recalculate the applicable financial reporting measure and the amount of incentive-based compensation based thereon. The issuer would then determine whether, based on that financial reporting measure as calculated relying on the original financial statements and taking into account any discretion that the compensation committee had applied to reduce the amount originally received, the executive officer received a greater amount of incentive-based compensation than would have been received applying the recalculated financial reporting measure.[161] Where

[150] Proposed Rule 10D–1(b)(1)(vi).

[151] *See* Section II.C.3.a, below, addressing the computation of excess incentive-based compensation for this form of compensation.

[152] *See, e.g.,* letters from Center on Executive Compensation, Compensia, Inc., Meridian Compensation Partners, LLC, Pay Governance LLC and Towers Watson.

[153] *See* letter from Compensia, Inc.

[154] *See* letter from Center on Executive Compensation.

[155] *See, e.g.,* letters from Compensia, Inc., and Meridian Compensation Partners, LLC.

[156] *See* letters from Center on Executive Compensation and Protective Life Corporation.

[157] *See* letter from Davis Polk & Wardwell LLP.

[158] *See* AFL-CIO Joint Letter.

[159] *See* letters from Clark Consulting, Davis Polk & Wardwell LLP and Frederic W. Cook & Co, Inc.

[160] Proposed Rule 10D–1(b)(1)(iii).

[161] For example, assume a situation in which, based on the financial reporting measure as originally reported, the amount of the award was $3,000. However, the issuer exercised negative discretion to pay out only $2,000. Following the restatement, the amount of the award based on the corrected financial reporting measure is $1,800. Taking into account the issuer's exercise of negative

Continued

incentive-based compensation is based only in part on the achievement of a financial reporting measure performance goal, 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. The issuer would then need to recalculate the affected portion based on the financial reporting measure as restated, and recover the difference between the greater amount based on the original financial statements and the lesser amount that would have been received based on the restatement.[162]

For incentive-based compensation that is based on stock price or total shareholder return, where the amount of erroneously awarded compensation is not subject to mathematical recalculation directly from the information in an accounting restatement, the recoverable amount may be determined based on a reasonable estimate of the effect of the accounting restatement on the applicable measure.[163] To reasonably estimate the effect on the stock price, there are a number of possible methods with different levels of complexity of the estimations and related costs.[164] For these measures, the issuer would be required to maintain documentation of the determination of that reasonable estimate and provide such documentation to the relevant exchange or association.[165]

The recoverable amount would be calculated on a pre-tax basis [166] to ensure that the company recovers the full amount of incentive-based compensation that was erroneously awarded, consistent with the policy underlying Section 10D. Recovery on a pre-tax basis also would permit the company to avoid the burden and administrative costs associated with calculating recoverable amounts based on the particular tax circumstances of individual executive officers, which may vary significantly based on factors independent of the incentive-based compensation.

While we intend for the definition to apply in a principles-based manner, we recognize that applying the principles may not always be simple. Cash awards that are received upon satisfaction of a financial reporting measure should be relatively straightforward. The recoverable amount would be the difference between the amount of the cash award (whether payable as a lump sum or over time) that was received and the amount that should have been received applying the restated financial reporting measure.[167]

For cash awards paid from bonus pools, the size of the aggregate bonus pool from which individual bonuses are paid would be reduced based on applying the restated financial reporting measure. If the reduced bonus pool is less than the aggregate amount of individual bonuses received from it, the excess amount of an individual bonus would be the *pro rata* portion of the deficiency. If the aggregate reduced bonus pool would have been sufficient to cover the individual bonuses received from it, then no recovery would be required.

Equity awards involve different considerations. For equity awards, if the shares, options or SARs are still held at the time of recovery, the recoverable amount would be the number received in excess of the number that should have been received applying the restated financial reporting measure. If the options or SARs have been exercised, but the underlying shares have not been sold, the recoverable amount would be the number of shares underlying the excess options or SARs applying the restated financial measure. If the shares have been sold, the recoverable amount would be the sale proceeds received by the executive officer with respect to the excess number of shares.[168] In any case in which the shares have been obtained upon exercise and payment of an exercise price, the recoverable amount would be reduced to reflect the applicable exercise price paid.[169]

We recognize that there may be circumstances in which both proposed Rule 10D–1 and SOX Section 304 could provide for recovery of the same incentive-based compensation. The proposed rule is not intended to alter or otherwise affect the interpretation of Section 304 or the determination by the Commission or the courts of when reimbursement is required under Section 304. If, however, an executive officer reimburses an issuer pursuant to Section 304, such amounts should be credited to the extent that an issuer's Rule 10D–1 recovery policy requires repayment of the same compensation by that executive officer. Further, recovery under Rule 10D–1 would not preclude recovery under Section 304 to the extent any applicable amounts have not been reimbursed to the issuer.

Request for Comment

43. Do the proposed rule and rule amendments articulate an appropriate standard for calculating the amount of excess incentive-based compensation that listed issuers must recover? Why or why not?

44. 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? Why or why not? Should we provide additional guidance regarding how such estimates should be calculated? If so, what particular factors should that guidance address?

45. As proposed, should the issuer be required to maintain documentation of the determination of that reasonable estimate and provide such documentation to the relevant exchange? Why or why not? Is the documentation required sufficient for compliance monitoring? If not, what else should be required? Should the rule specify a period of time that an issuer would need to maintain such documentation or what types of documentation should be maintained? If so, what period of time or

discretion, the recoverable amount would be $200 (*i.e.*, $2,000—$1,800).

[162] For example, assume a situation in which, based on the financial reporting measure as originally reported, the amount of the award was $3,000. The issuer exercised positive discretion to increase the amount by $1,000, paying out a total of $4,000. Following the restatement, the amount of the award based on the corrected financial reporting measure is $1,800. Taking into account the issuer's exercise of positive discretion, the recoverable amount would be $1,200, provided that based on the revised measurement, the exercise of positive discretion to increase the amount by $1,000 was still permitted under the terms of the plan.

[163] Proposed Rule 10D–1(b)(1)(iii)(A).

[164] *See* Section III.B.2, below, discussing different methodologies for determining a reasonable estimate of the effect of the accounting restatement on the stock price or total shareholder return.

[165] Proposed Rule 10D–1(b)(1)(iii)(B).

[166] Proposed Rule 10D–1(b)(1)(iii) provides that the erroneously awarded compensation shall be computed without regard to any taxes paid by the executive officer. The pre-tax amount refers to the full amount of incentive-based compensation received by the executive officer, rather than the amount remaining after he or she satisfies his or her personal income tax obligation on it.

[167] Similarly, for nonqualified deferred compensation, the executive officer's account balance or distributions would be reduced by the excess incentive-based compensation contributed to the nonqualified deferred compensation plan and the interest or other earnings accrued thereon under the nonqualified deferred compensation plan. In addition, for retirement benefits under pension plans, the excess incentive-based compensation would be deducted from the benefit formula, and any related distributions would be recoverable.

[168] Where excess shares have been gifted, such as gifts to charities, the recoverable amount would be the gifted shares' fair market value at the date of the gift.

[169] Shares sold can be traced consistent with Treas. Reg. 1.1012–1(c) and Rule 144(d) [17 CFR 230.144(d)].

documentation is appropriate? Should we require that such determination be disclosed, either to the exchange or in Commission filings? What would be the effects of such disclosure?

46. Should the rule and rule amendments alternatively, or in addition, include specific instructions for how to compute the excess amount of specific forms of incentive-based compensation? If so, which ones and why?

47. Is further guidance needed on the application of the proposed standard? If yes, what additional guidance is necessary? Is further guidance required regarding any particular form of compensation? For example:

a. Should we provide guidance on how to determine the recoverable amount of supplemental retirement plan benefits that are calculated based on erroneously awarded incentive-based compensation? If so, what should that guidance be?

b. For equity awards granted based on satisfaction of a financial reporting measure, the guidance above directs listed issuers to recover the excess number of shares or, if no longer held, the proceeds from the sale of the excess shares so that executive officers cannot benefit from future appreciation in shares that were not earned. Instead of recovering the excess number of shares, should listed issuers have the choice to recover the cash value of the excess shares? If so, should the shares be valued at the vesting date, the date the recoverable amount is determined, or some other date?

c. Where the number of excess shares is less than the entire award and some of the shares received were sold and some are still held, should recovery be made first against the remaining shares that are held? Alternatively, should recovery apply first to shares that were sold, so as not to erode company stock holding policies? Should this decision be left to the listed issuer's discretion?

d. Where excess shares have been gifted, such as gifts to charities, should the recoverable amount be the shares' fair market value at the date of the gift? If not, at what other date should the excess shares be valued?

e. Is the guidance above appropriate for determining the recoverable amount where the listed issuer has exercised discretion to reduce or increase the original amount of incentive-based compensation received?

48. Where the issuer chose to increase the original amount of incentive-based compensation, should an amount proportionate to the effect of the restatement on the financial statement measure also be recovered from the discretionary enhancement?

49. One commenter recommended that the Commission require recovery of a proportionate amount of incentive compensation awarded under qualitative standards.[170] Should we require recovery of amounts awarded under qualitative standards that may involve judgement by the board? If so, how would the excess compensation be calculated in those instances?

50. Is further guidance needed regarding circumstances in which both proposed Rule 10D–1 and SOX Section 304 would apply?

b. Board Discretion Regarding Whether To Seek Recovery

Section 10D requires exchanges and associations to adopt listing standards that require issuers to adopt and comply with recovery policies. Specifically, the statute provides that ''the issuer will recover'' incentive-based compensation, and does not address whether there are circumstances in which an issuer's board of directors may exercise discretion not to recover.

Commenters suggested that the Commission's implementing rules should address the issue of board discretion whether to pursue recovery and, if such discretion is permitted, address its scope. Many of these commenters asserted that the Commission should allow for board discretion to determine whether to pursue recovery.[171] Commenters raised concerns about situations where the potential costs of recovery may exceed the excess incentive-based compensation to be recovered [172] and recommended that boards be permitted to evaluate the benefits of recovery against the costs involved.[173] Commenters noted the following factors that may affect this decision: the likelihood of recovery; [174] *de minimis* recovery; [175] the need to pursue litigation to recover; [176] and the possibility that recovery might violate existing statutory or contractual provisions.[177] One commenter asserted that in the absence of discretion, companies will be incentivized to implement compensation arrangements that are not subject to Section 10D recovery provisions.[178] Other commenters recommended the Commission establish a standard similar to the Troubled Asset Relief Program (''TARP'') standard where an issuer is not required to enforce its recovery policy if it would be unreasonable to do so.[179]

In considering this issue, we note that the Emergency Economic Stabilization Act of 2008 (''EESA'') contained an executive compensation recovery provision [180] applicable to any financial institution that sells troubled assets to the Secretary of the United States Department of the Treasury under TARP. In its interim final rule to provide guidance on the EESA's executive compensation and corporate governance provisions applicable to entities receiving financial assistance under TARP, the Department of the Treasury provided that ''[t]he TARP recipient must exercise its clawback rights except to the extent it demonstrates that it is unreasonable to do so, such as, for example, if the expense of enforcing the rights would exceed the amount recovered.'' [181]

We are mindful that allowing discretion whether to recover excess incentive-based compensation could undermine the purpose of Section 10D by permitting an issuer's board of directors to determine that an executive officer may retain incentive-based compensation to which he or she is not entitled. At the same time, we acknowledge that there are circumstances in which pursuing

[170] *See* AFL-CIO Joint Letter.

[171] *See* letters from Davis Polk & Wardwell LLP, Center on Executive Compensation, Meridian Compensation Partners, LLC, American Benefits Council, Baker, Donelson, Bearman, Caldwell & Berkowitz, PC, Compensia, Inc., Clark Consulting, LLC, Society of Corporate Secretaries and Governance Professionals, Frederic W. Cook & Co., Inc., Stuart R. Lombardi and Protective Life Corporation.

[172] *See* letters from Clark Consulting, LLC and ABA Business Law Section.

[173] *See* letters from Davis Polk & Wardwell LLP, Meridian Compensation Partners, LLC, American Benefits Council, Compensia, Inc., Clark Consulting, LLC, Society of Corporate Secretaries and Governance Professionals, Stuart R. Lombardi and Protective Life Corporation.

[174] *See* letter from Society of Corporate Secretaries and Governance Professionals.

[175] *See* letters from Center on Executive Compensation, Meridian Compensation Partners, LLC, American Benefits Council, Frederic W. Cook & Co., Inc., and Protective Life Corporation.

[176] *See* letters from Society of Corporate Secretaries and Governance Professionals and Center on Executive Compensation.

[177] *See* letters from Society of Corporate Secretaries and Governance Professionals and Center on Executive Compensation.

[178] *See* letter from Stuart R. Lombardi. To guard against the abuse of discretion, this commenter recommended that following a restatement an issuer either should publicly announce its decision whether to pursue or decline recovery, or should delegate all clawback decision making authority to an independent party.

[179] *See* letters from Baker, Donelson, Bearman, Caldwell & Berkowitz, PC and Compensia, Inc.

[180] Section 111(b)(3)(B) of EESA, Public Law 110–343, 12 U.S.C. 5221, as amended by Title VII of Division B of the American Recovery and Reinvestment Act of 2009 (''ARRA''), Public Law 111–5 [123 STAT. 115] (Feb. 17, 2009).

[181] TARP Standards for Compensation and Corporate Governance, 31 CFR 30.8.

recovery of excess incentive-based compensation may not be in the interest of shareholders and that a standard similar to the TARP standard would permit boards of directors to evaluate whether to pursue recovery of excess incentive-based compensation in particular circumstances.

To address these circumstances, proposed Rule 10D–1 would provide 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. We believe the unqualified ''no-fault'' recovery mandate of Section 10D intends that the issuer should pursue recovery in most instances. For example, we do not believe the extent to which an individual executive officer may be responsible for the financial statement errors requiring the restatement could be considered in seeking the recovery. Further, we do not view inconsistency between the proposed rule and rule amendments and existing compensation contracts, in itself, as a basis for finding recovery to be impracticable, because issuers can amend those contracts to accommodate recovery.[182]

In our view, the only criteria that should be considered are whether the direct costs of enforcing recovery would exceed the recoverable amounts or whether recovery would violate home country law. Before concluding that it would be impracticable to recover any amount of excess incentive-based compensation based on enforcement costs,[183] the issuer would first need to make a reasonable attempt to recover that incentive-based compensation.[184] The issuer would be required to document its attempts to recover, and provide that documentation to the exchange.[185] As described in Section II.D, below, the issuer also would be required to disclose why it determined not to pursue recovery. We believe that in this circumstance requiring an attempt to recover is both consistent with the no-fault character of Section 10D, and necessary for the issuer to justify concluding that recovery of the amount at issue would be impracticable. Similarly, before concluding that it would be impracticable to recover because doing so would violate home country law, the issuer first would need to obtain an opinion of home country counsel, not unacceptable to the applicable national securities exchange or association, that recovery would result in such a violation.[186] In addition, to minimize any incentive countries may have to change their laws in response to this provision, the relevant home country law must have been adopted in such home country prior to the date of publication in the **Federal Register** of proposed Rule 10D–1.

In either case, to prevent potential conflicts of interest, any determination that recovery would be impracticable would need to be made by the issuer's committee of independent directors that is responsible for executive compensation decisions.[187] In the absence of a compensation committee, the determination would need to be made by a majority of the independent directors serving on the board. Such a determination, as with all determinations under proposed Rule 10D–1, would be subject to review by the listing exchange.[188]

We believe that the proposed issuer discretion is necessary or appropriate in the public interest and consistent with the protection of investors because it would save issuers the expense of pursing recovery in circumstances where the costs of recovery could exceed or be disproportionate to the recoverable amounts, and for foreign private issuers, would avoid such issuers having to choose between potential de-listing or violating home country laws, either of which could be detrimental to shareholders. Further, as discussed below,[189] we propose to require a listed issuer to disclose the reasons why it decided not to pursue recovery in particular instances. We believe that requiring this disclosure will mitigate potential abuse of this discretion.

Request for Comment

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?

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?

53. Should the issuer first be required to make a reasonable attempt to recover that compensation, as proposed? If so, should we specify what steps to recover excess incentive-based compensation should be required or what constitutes a ''reasonable attempt'' to recover such compensation? Should this requirement depend on what financial reporting metric triggers recovery? Should the issuer be required to document its attempts to recover, and provide that documentation to the exchange?

54. Should a listed issuer be permitted to forego recovering incentive-based compensation if doing so would violate home country law? In this circumstance, should the issuer first be required to obtain a legal opinion from home country counsel, as proposed? If not, why not? Are there any other conditions that should be met beyond a legal opinion from home country counsel before an issuer should be permitted to forego recovering incentive-based compensation in these circumstances? Should the proposed accommodation apply only to the extent that recovery would conflict with home country laws in effect before the date of publication of proposed Rule 10D–1 in the **Federal Register**, as proposed? If not, please explain why not. In addition, as proposed, the listed issuer would need to provide such opinion to the

[182] We note that some have suggested that issuers may be able to amend their by-laws to implement their recovery policies. *See, e.g.*, Robert E. Scully Jr, Executive Compensation, the Business Judgment Rule, and the Dodd-Frank Act: Back to the Future for Private Litigation?, The Federal Lawyer, January 2011, pp 39–41.

[183] Only direct costs involving financial expenditures, such as reasonable legal expenses, would be considered for this purpose. Indirect costs relating to concerns such as reputation or the effect on hiring new executive officers would not be taken into account.

[184] Proposed Rule 10D–1(b)(1)(iv).

[185] *Id.*

[186] *Id.* The listed issuer would need to provide such opinion to the exchange or association.

[187] Exchange Act Rule 10C–1 mandated that the exchanges adopt listing standards to require that directors responsible for oversight of executive compensation (whether or not serving as part of a formal compensation committee) be independent. Examples of such listing standards are Section 303A.05 of the NYSE Listed Company Manual and NASDAQ Rule 5605(d), both of which require listed companies, with limited exceptions, to have a compensation committee composed entirely of independent directors. Listed companies were given until the earlier of their first annual meeting of shareholders after January 15, 2014 or October 31, 2014 to comply with the revised NYSE and Nasdaq independence requirements for compensation committee members.

[188] Proposed Rule 10D–1(b)(1)(iv).

[189] *See* Section II.D.1, below.

exchange upon request. Should a copy of this opinion be filed with the Commission as an exhibit? Why or why not?

55. 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? If not, why not, and who should be authorized to make the determination?

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.

57. Could application of the Section 10D recovery policy to current or former employees cause an issuer to violate any existing statutory or contractual provisions? If so, please specify the applicable provisions, how they might make affect recovery, and how an issuer could address them to implement recovery.

58. Would issuers be able to implement their recovery policies with respect to existing compensation agreements and arrangements through amendments to their by-laws?

c. Board Discretion Regarding Manner of Recovery

Section 10D does not address whether an issuer's board of directors may exercise discretion in the manner in which it recovers excess compensation to comply with the listing standards. Commenters suggested that the Commission's rule and rule amendments should address whether boards may exercise discretion in effecting recovery in two primary areas—the amount to be recovered when discretion was exercised in the original grant, and the means of recovery.

i. Amount To Be Recovered

Commenters requested that boards be able to exercise discretion with regard to the amount to be recovered when discretion was used in determining the original award amount.[190] For example, some issuers use ''pool plans,'' in which the size of the available bonus pool is determined based wholly or in part on satisfying a financial reporting measure performance goal, but specific amounts granted from the pool to individual executives are based on discretion. One commenter recommended that the issuer's board of directors have the discretion to decide how much to recover from each executive officer, as long as the issuer recovers the aggregate erroneously awarded amount.[191] A different commenter stated that the issuer's board should be given the same level of discretion to determine the amount to be recovered from individual executive officers as was used in making the initial compensation decision.[192] This commenter also suggested that the Commission consider situations in which the issuer's board would be permitted to settle for less than the full amount when seeking recovery under its recovery policy.[193]

As proposed, Rule 10D–1 would not limit the amount of compensation the board could seek to recover on any other legal basis. However, under the proposed rule, issuers' boards of directors would not be permitted to pursue differential recovery among executive officers, including in ''pool plans,'' where the board may have exercised discretion as to individual grants in allocating the bonus pool. In this instance, we believe that recovery should be *pro rata* based on the size of the original award rather than discretionary. We believe that permitting discretion in these instances would be inconsistent with Section 10D's no-fault standard and its goal of preventing executive officers from retaining compensation to which they are not entitled under the restated financial reporting measure. Additionally, permitting discretion in these instances could result in issuers selectively applying recovery policies to former executive officers, which we believe also would be inconsistent with Section 10D's purpose.

Moreover, consistent with Section 10D's emphasis on preventing executive officers from retaining compensation that they received and to which they were not entitled under the issuer's restated results, and as described above, we are not proposing that issuers be permitted to settle for less than the full recovery amount unless impracticable from a cost standpoint. In that circumstance, the same conditions would apply as for a determination to forgo recovery.[194]

ii. Means of Recovery

In addition, several commenters recommended that boards of directors be able to exercise discretion on how to accomplish recovery under the recovery policy required by the proposed listing standards.[195] One commenter suggested that boards may decide to recover the excess compensation over time or from future pay,[196] while another commenter recommended that issuers recover erroneously paid compensation first from current compensation owing, and then from executive officers' after-tax funds.[197] One commenter recommended that recovery of an incentive-based compensation award that has been earned but not paid should be accomplished through forfeiture of the award, while recovery in all other cases should be accomplished solely by the executive officer's repayment.[198] Several commenters suggested cancellation of unvested equity and non-equity awards or offsetting against amounts otherwise payable by the issuer to the executive officer, such as deferred compensation, as possible recovery methods.[199]

We recognize that the appropriate means of recovery may vary by issuer and by type of compensation arrangement. Consequently, we believe issuers should be able to exercise discretion in how to accomplish recovery. Nevertheless, in exercising this discretion, we believe that issuers should act in a manner that effectuates the purpose of the statute—to prevent executive officers from retaining compensation that they received and to which they were not entitled under the issuer's restated results. Regardless of the means of recovery utilized, we believe that issuers should recover excess incentive-based compensation reasonably promptly, as undue delay would constitute non-compliance with an issuer's policy as required.

Request for Comment

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

[190] *See* letters from Davis Polk & Wardwell LLP, Center on Executive Compensation and Society of Corporate Secretaries and Governance Professionals. *See* Section II.C.3.a, above, regarding the amount to be recovered when discretion was used to either increase or decrease the original award amount.

[191] *See* letter from Protective Life Corporation.

[192] *See* letter from Center on Executive Compensation.

[193] *See* letter from Center on Executive Compensation.

[194] *See* Section II.C.3.b, above.

[195] *See* letters from Davis Polk & Wardwell LLP, Center on Executive Compensation, Pay Governance LLC, Society of Corporate Secretaries and Governance Professionals, Stuart R. Lombardi and Protective Life Corporation.

[196] *See* letter from Davis Polk & Wardwell LLP.

[197] *See* letter from Frederic W. Cook & Co., Inc.

[198] *See* letter from Meridian Compensation Partners, LLC.

[199] *See* letters from Center on Executive Compensation, Society of Corporate Secretaries and Governance Professionals and Protective Life Corporation.

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.

61. Would the exercise of discretion by an issuer's board of directors on the amount to be recovered where discretion was used in determining the original award amount (*e.g.,* in a pool plan) be consistent with the purpose of Section 10D? If so, how?

a. If an issuer uses a pool plan in which achievement of a financial reporting measure determines the aggregate amount of the bonus pool and the bonus pool is insufficient after giving effect to the restatement, how should the issuer determine the amount to be recovered? Should this decision be left to the board of directors or compensation committee? Should recovery be on a *pro rata* basis?

62. Should an issuer's board of directors be able to exercise discretion regarding the means of recovery, as proposed? If so, how and under what circumstances should the board be able to exercise discretion regarding the means of recovery? Are there any steps the board should be required to take before it exercises any permitted discretion regarding the means of recovery?

63. Should any of the principles discussed in this section be codified?

64. Should deferred payment arrangements be permitted when an executive officer otherwise is unable to repay excess incentive-based compensation? If so, should the time period over which repayment may be deferred be limited?

65. If recovery does not occur reasonably promptly, this would constitute non-compliance with an issuer's policy. Should there be an explicit window of time within which an issuer must have recovered excess incentive-based compensation from an executive beyond which the failure to recover would not be considered ''reasonably prompt''? Why or why not? If so, what should that time period be?

66. Should an issuer be permitted to recover excess incentive-based compensation by netting incentive-based compensation overpayments with incentive-based compensation underpayments that result from restating financial statements for multiple periods during the three-year recovery period? For example, suppose an issuer's restatement for a material error in revenue recognition results in a shift in revenue from the most recent year to an earlier year in the three-year period, such that an incentive payment in the earlier year would have been greater under the restatement. Should the issuer be permitted to recover the excess incentive-based compensation in the later year by crediting the earlier ''underpayment''? Why or why not? Should the conclusion be different from the situation where the executive officer received incentive-based compensation due to the achievement of a cumulative performance goal for the three-year period based on the financial reporting measure? Why or why not?

67. One commenter suggested that we specifically authorize or approve of the use of a nonqualified deferred compensation plan (*e.g.,* a ''holdback plan'' or ''bonus bank'') to aid in the recovery of erroneously awarded incentive-based compensation.[200] Would these or other mechanisms aid in the recovery of such compensation? Why or why not?

4. Compliance With Recovery Policy

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.[201] The proposed rule and rule amendments do not specify the time by which the issuer must complete the recovery of excess incentive-based compensation. Rather, under proposed Rule 10D–1, an exchange would determine whether the steps an issuer is taking constitute compliance with its recovery policy. In making this assessment, an exchange would need to determine, among other things, whether the issuer was making a good faith effort to promptly pursue recovery.

Request for Comment

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?

69. Should Rule 10D–1 provide an objective standard to determine whether an issuer is complying with its recovery policy? For example, if the issuer has not recovered a certain percentage of excess incentive-based compensation within a certain time period after a restatement that triggers application of the policy, should it be deemed non-compliant? If so, what percentages or time periods should be used, and why?

70. Alternatively, should Rule 10D–1 provide a standard that includes different subjective criteria, or both subjective and objective criteria, to determine whether an issuer is complying with its recovery policy? If so, what standard should be used and why?

71. Are there procedures that should be considered to assess compliance with an issuer's policies and procedures concerning recovery of excess incentive-based compensation? If so, what are they? Should an issuer be required to disclose those policies and procedures? Should there be an independent third-party assessment of an issuer's compliance with those policies and procedures?

72. Could proposed Rule 10D–1 be revised to better ensure compliance with the obligation to recover? If so, how?

D. Disclosure of Issuer Policy on Incentive-Based Compensation

Section 10D(b)(1) requires exchanges and associations to adopt listing standards that call ''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.'' Sections 10D(a) and (b) require that the Commission adopt rules requiring the exchanges to prohibit the listing of any security of an issuer that does not develop and implement a policy providing for such disclosure.

Commenters noted that Section 10D(b)(1) could be read either to require disclosure about the issuer's policy on incentive-based compensation generally, or, instead, to require disclosure only about the issuer's recovery policy with regard to such compensation. One commenter[202] requested that the Commission address how the disclosure required by Section 10D(b)(1) would relate to the recovery policy disclosure already provided in an issuer's CD&A.[203] Another commenter recommended implementing Section 10D(b)(1)'s disclosure requirement by mandating that CD&A include the type of disclosure currently addressed but not mandated under Item 402(b)(2)(viii) of Regulation S–K, to the extent that such policies relate to financial

[200] *See* letter from Clark Consulting.

[201] Under the proposed rule and rule amendments, it would also be subject to delisting if it does not disclose its compensation recovery policy in accordance with Commission rules.

[202] *See* letter from Baker, Donelson, Bearman, Caldwell & Berkowitz, PC.

[203] Item 402(b)(2)(viii) provides as an example of information that may be material information to be disclosed under CD&A ''[r]egistrant policies and decisions regarding the adjustment or recovery of awards or payments if the relevant registrant performance measures upon which they are based are restated or otherwise adjusted in a manner that would reduce the size of an award or payment.''

information required to be reported under the securities laws.[204]

A different commenter recommended that the Commission not interpret Section 10D(b)(1) as creating a new disclosure requirement for incentive-based compensation or, if the Commission does adopt a separate disclosure requirement, that it allow the requirement to be satisfied by identifying any types of incentive-based compensation that are based on financial information that is required to be reported under the securities laws.[205] This commenter further recommended that the Commission allow an issuer to present any required disclosure on its general corporate Web site in view of the information about incentive-based compensation that is currently required in proxy materials under Item 402 of Regulation S–K.

Other commenters sought disclosure of issuers' clawback decisions. One commenter recommended public disclosure of an issuer's decision whether or not to pursue recovery as a means to prevent abuse of any permitted discretion.[206] A different commenter stated that in addition to disclosing the existence of a clawback policy, listed issuers should be required to disclose whether or not recovery has been initiated and completed, along with details of the sums recovered and identity of executives from whom compensation was recovered, as a prophylactic against firms that restate but do not meet their obligation to recover funds.[207]

In part, because Section 10D(b)(1) comes under the Section 10D(b) heading ''Recovery of Funds,'' we construe its disclosure requirement to mean disclosure of the listed issuer's policy related to recovery of erroneously awarded compensation. This approach would permit an assessment of a listed issuer's compliance with the mandatory recovery policy, while avoiding a potential duplication of the existing disclosure requirements applicable to incentive-based compensation. The proposed disclosure requirements are intended to inform shareholders and the listing exchange as to both the substance of a listed issuer's recovery policy and how the listed issuer implements that policy in practice.

While the specific language of Sections 10D(a) and (b) may be ambiguous, we believe that it is intended to require listed issuers to adopt, comply with, and provide disclosure about their compensation recovery policies. Accordingly, proposed Rule 10D–1 would call for the listing standards to include among the new requirements that listed issuers disclose their recovery policies.[208] Implementing the disclosure requirement as an element of the listing standards would permit exchanges to commence de-listing proceedings for issuers that fail to make the required disclosure, as well as those that fail to adopt recovery policies or fail to comply with their terms.

Further, to provide consistent disclosure across exchanges, proposed Rule 10D–1 would provide that the required disclosure about the issuer's recovery policy must be filed in accordance with the disclosure requirements of the federal securities laws. These requirements would be implemented by the proposed amendments to Regulation S–K and relevant forms described below. Structuring the provision in this manner would assure that, in addition to making the disclosure a condition to listing, it would be subject to Commission oversight to the same extent as other disclosure required in Commission filings.

Finally, to facilitate verification of compliance by the exchanges, the listing standards of each exchange would require that listed issuers record their compensation recovery policies in writing, and these recovery policies would be filed with the Commission, as described immediately below.

1. Listed U.S. Issuers

The first of the proposed disclosure requirements would amend Item 601(b) of Regulation S–K to require that a listed issuer file its recovery policy as an exhibit to its annual report on Form 10–K.[209] For this purpose, an issuer would be ''a listed issuer'' if it had a class of securities listed on an exchange registered pursuant to Section 6 of the Exchange Act or an association registered pursuant to Section 15A of the Exchange Act at any time during its last completed fiscal year. Because the disclosure is keyed to the statutorily mandated listing requirement, we would apply this disclosure requirement to all listed issuers and do not propose to apply it to issuers who do not have a listed class of securities.

Although not specifically required by the Act, to further implement Section 10D(b)(1), we are also using our discretionary authority to propose to amend Item 402 of Regulation S–K to require listed issuers to disclose how they have applied their recovery policies. Proposed Item 402(w) of Regulation S–K would apply if at any time during its last completed fiscal year either a restatement that required recovery of excess incentive-based compensation pursuant to the listed issuer's compensation recovery policy was completed or there was an outstanding balance of excess incentive-based compensation from the application of that policy to a prior restatement. In this circumstance, the listed issuer would be required to provide the following information in its Item 402 disclosure:

- For each restatement, the date on which the listed issuer was required to prepare an accounting restatement, the aggregate dollar amount of excess incentive-based compensation attributable to such accounting restatement and the aggregate dollar amount of excess incentive-based compensation that remains outstanding at the end of its last completed fiscal year;[210]
- The estimates used to determine the excess incentive-based compensation attributable to such accounting restatement, if the financial reporting measure related to a stock price or total shareholder return metric;
- The name of each person subject to recovery of excess incentive-based compensation attributable to an accounting restatement, if any, from whom the listed issuer decided during the last completed fiscal year not to pursue recovery, the amount forgone for each such person, and a brief description of the reason the listed issuer decided in each case not to pursue recovery; and
- The name of, and amount due from, each person from whom, at the end of its last completed fiscal year, excess incentive-based compensation had been outstanding for 180 days or longer since the date the issuer determined the amount the person owed.

As proposed, the disclosure would show a listed issuer's activity to recover excess incentive-based compensation

[204] *See* letter from ABA Business Law Section.

[205] *See* letter from Compensia, Inc.

[206] *See* letter of Stuart R. Lombardi.

[207] *See* AFL–CIO Joint Letter, suggesting that this disclosure be in the Form 8–K.

[208] Proposed Rule 10D–1(b)(1).

[209] Proposed Item 601(b)(96) of Regulation S–K. The Form 20–F Instructions as to Exhibits would be amended correspondingly to add new Instruction 17. Similarly, Form 40–F would be amended to add new paragraph (17(a)) to General Instruction B. Form N–CSR would be amended to renumber Item 12 (Exhibits) as Item 13 and add new paragraph (a)(3) to that item for those registered management investment companies that would be subject to the requirements of proposed Rule 10D–1.

[210] Proposed Instruction 4 to Item 402(w) would provide that if the aggregate dollar amount of excess incentive-based compensation has not yet been determined, the listed issuer would disclose this fact and explain the reasons.

during its last completed fiscal year. We believe this disclosure would inform shareholders' voting and investment decisions and help exchanges ensure compliance with their listing standards. All listed issuers would be subject to Item 402(w) disclosure.[211] The proposed disclosure would be included along with the listed issuer's other Item 402 disclosure in annual reports on Form 10–K and any proxy and consent solicitation materials that require executive compensation disclosure pursuant to Item 402 of Regulation S–K.[212] As proposed, a listed issuer that complies with its Item 402(w) disclosure requirements would not need to disclose any incentive-based compensation recovery pursuant to Item 404(a).[213] With respect to registered management investment companies subject to proposed Rule 10D–1, information mirroring the proposed Item 402(w) disclosure would be included in annual reports on Form N–CSR and in proxy statements and information statements relating to the election of directors.[214]

Since our proposal would apply to *any* current or former executive officer to recovery, rather than only the ''named executive officers'' whose compensation is subject to discussion in CD&A, we propose this disclosure requirement as a separate item rather than as an amendment to CD&A. If the listed issuer is required to provide CD&A under Item 402 of Regulation S–K, however, the listed issuer could choose to include the disclosure required by proposed Item 402(w) in its CD&A discussion of its recovery policies and decisions pursuant to Item 402(b)(2)(viii) of Regulation S–K. Such a practice could benefit investors by disclosing all compensation recovery information in a single location in the filing.

We also considered implementing Section 10D(b)(1)'s disclosure requirement by mandating that CD&A include the type of disclosure currently addressed but not mandated under Item 402(b)(2)(viii) of Regulation S–K, to the extent that such policies relate to financial information required to be reported under the securities laws. This approach, however, would always locate the disclosure in CD&A, a section that requires discussion of the compensation awarded to, earned by, or paid to the smaller group of ''named executive officers.'' Further, smaller reporting companies, emerging growth companies and foreign private issuers are not required to provide CD&A in their filings and proposed Item 402(w) disclosure would be required in some filings that do not require CD&A disclosure.[215] In addition, the disclosure called for by CD&A is not limited to recovery triggered by the restatement of a financial reporting measure, but instead encompasses other adjustments that would reduce the size of an award or payment, including with respect to an award based on a strategic or operational measure.[216]

We are also proposing amendments to the Summary Compensation Table disclosure requirements. A new instruction to the Summary Compensation Table would require that any amounts recovered pursuant to a listed issuer's erroneously awarded compensation recovery policy reduce the amount reported in the applicable column for the fiscal year in which the amount recovered initially was reported, and be identified by footnote.[217] For example, if a listed issuer reported that in 2016 its Principal Executive Officer earned $1 million in non-equity incentive plan award compensation, and in 2017 a restatement of 2016 financial statements resulted in recovery of $300,000 of that incentive-based compensation, the 2017 Summary Compensation Table would revise the 2016 reported amount to $700,000, with footnote disclosure of the $300,000 recovered. The Summary Compensation Table ''total'' column would also be revised the same way. The new instruction would apply in any filing requiring Summary Compensation Table disclosure covering the affected fiscal year, including in Securities Act registration statements.

We are proposing that the disclosure required by proposed Item 402(w) be provided in interactive data format using XBRL using block-text tagging.[218] The interactive data would have to be provided as an exhibit to the definitive proxy or information statement filed with the Commission and as an exhibit to the annual report on Form 10–K.[219] Issuers would be required to prepare their interactive data using the list of tags the Commission specifies and submit them with any supporting files the EDGAR Filer Manual prescribes.[220] This requirement generally would apply to all listed issuers.[221] We believe requiring the data to be tagged would lower the cost to investors of collecting this information, and would permit data to be analyzed more quickly by shareholders, exchanges and other end-users than if the data was provided in a non-machine readable format.

2. Listed Foreign Issuers

Foreign private issuers, including Canadian issuers using the MJDS, would be required to provide the same information called for by Item 402(w) in, and to file their erroneously awarded

[211] *See* proposed Instruction 1 to Item 402(w), defining the term ''listed registrant; and proposed Instruction 2 to Item 402(w) defining the term ''compensation recovery policy.''

[212] Proposed Instruction 5 to Item 402(w).

[213] Proposed Instruction 5.a.iii to Item 404(a) of Regulation S–K. Item 404(a) requires a description of any transaction, since the beginning of the issuer's last fiscal year, or any currently proposed transaction, in which the issuer was or is to be a participant and the amount involved exceeds $120,000, and in which any related person had or will have a direct or indirect material interest. For registered management investment companies, *see* proposed Instruction 1 to Item 22(b)(20) of Schedule 14A (information provided pursuant to Item 22(b)(20) is deemed to satisfy the requirements of paragraphs (b)(8) and (b)(11) of Item 22 with respect to the recovery of erroneously awarded compensation pursuant to Rule 10D–1(b)(1)).

[214] Proposed Item 12 of Form N–CSR; proposed Item 22(b)(20) of Schedule 14A. We are also proposing to amend General Instruction D to Form N–CSR to permit registered management investment companies subject to proposed Rule 10D–1 to answer the information required by proposed Item 12 by incorporating by reference from the company's definitive proxy statement or definitive information statement.

[215] Smaller reporting companies and emerging growth companies are not required to provide CD&A in accordance with the scaled disclosure requirements contained in Item 402 of Regulation S–K. *See* Item 402(*l*) of Regulation S–K and Section 102(c) of the JOBS Act. Foreign private issuers and filers under the multijurisdictional disclosure system (''MJDS'') who file annual reports on Form 20–F or Form 40–F, respectively, are not subject to Item 402 of Regulation S–K and are not required to provide CD&A. *See* Form 20–F and Form 40–F. Similarly, foreign private issuers electing to use U.S. issuer registration and reporting forms are not required to provide CD&A because they will be deemed to comply with Item 402 by providing the information required by Items 6.B and 6.E of Form 20–F, with more detailed information provided if otherwise made publicly available or required to be disclosed by the issuer's home jurisdiction or a market in which its securities are listed or traded. *See* Item 402(a)(1) of Regulation S–K.

In addition, Form N–CSR and Schedule 14A do not require registered investment companies to provide CD&A disclosure. Currently, registered investment companies are not subject to Item 402 disclosure. We are proposing that registered management investment companies subject to proposed Rule 10D–1 would provide information mirroring the proposed Item 402(w) disclosure in annual reports on Form N–CSR pursuant to proposed Item 12 of that form, and in proxy statements and information statements pursuant to proposed Item 22(b)(20) of Schedule 14A.

[216] Item 402(b)(2)(viii) of Regulation S–K: ''Registrant policies and decisions regarding the adjustment or recovery of awards or payments if the relevant registrant performance measures upon which they are based are restated or otherwise adjusted in a manner that would reduce the size of an award or payment.''

[217] Proposed Instruction 5 to Item 402(c), and proposed Instruction 5 to Item 402(n).

[218] Data becomes interactive when it is labeled or ''tagged'' using a computer markup language such as XBRL that software can process for analysis.

[219] Proposed Item 25 of Schedule 14A and proposed Item 601(b)(97) of Regulation S–K.

[220] The EDGAR Filer Manual is available at: *http://www.sec.gov/info/edgar/edmanuals.htm.*

[221] *See* n. 229, below.

compensation policies as an exhibit to, the annual reports they file with the Commission pursuant to Section 13(a) of the Exchange Act.[222] We propose to require foreign private issuers, including MJDS filers, to disclose the information in annual reports they file on Form 20–F, Form 10–K [223] and Form 40–F, as applicable. Because securities registered by these listed issuers are exempt from Section 14(a) of the Exchange Act,[224] they would not be required to disclose the information in any proxy or consent solicitation materials with respect to their securities.

Form 20–F is used as either the registration statement or annual report for foreign private issuers under the Exchange Act.[225] The proposals would amend Item 402(a)(1) to add proposed Item 6.F of Form 20–F to the list of mandatorily required executive compensation disclosures for foreign private issuers.[226] As proposed, Item 6.F would mirror the disclosure requirements of Item 402(w). In addition, a listed foreign private issuer that provides the disclosure required by Item 6.F of Form 20–F would not need to provide Item 7.B [227] disclosure of any individual excess incentive-based compensation recovery transaction otherwise subject to Item 7.B.[228] We are proposing a similar amendment to Form 40–F to add Paragraph (17) of General Instruction B to mirror the disclosure requirements of Item 402(w). As discussed above, listed issuers would generally be required to tag this disclosure in an interactive data format.[229]

Request for Comment

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.

75. Should a listed issuer be required, as proposed, to file as an exhibit to its Exchange Act annual report its policy regarding the recovery of incentive-based compensation that is based on or derived from financial information required to be reported under the securities laws? Are there better ways to disclose the policy? Should the policy be included in the text of the Exchange Act annual report?

76. Would proposed Item 402(w) and the proposed amendment to Item 404 elicit the appropriate level of detail about how issuers have applied their recovery policies? Should listed issuers be required to disclose the names of executive officers from whom recovery has been forgone, the amounts forgone and the reason the listed issuer decided not to pursue recovery? Should listed issuers be required to disclose the names of executive officers from whom, as of the end of the last completed fiscal year, excess incentive-based compensation had been outstanding for 180 days or longer since the date the issuer determined the amount the person owed? If not, are there different disclosures that should be required?

77. Should an issuer also be required to disclose the basis of the determination of the amount of excess incentive-based compensation and any critical estimates used in determining the amounts? Should a listed issuer also be required to disclose the process or procedures by which it will seek to recover excess incentive-based compensation for amounts in which it is seeking recovery? Why or why not? If not, what should be disclosed and why?

78. As proposed, Item 402(w) disclosure would be required if at any time during the last completed fiscal year either a restatement was completed that required recovery pursuant to the listed issuer's compensation recovery policy, or there was an outstanding balance of excess incentive-based compensation based on application of that policy to a prior restatement. Should the disclosure proposed in Item 402(w) be required in both these circumstances? If not, please explain why. Will it be clear if a restatement was completed during a fiscal year, such that disclosure would be required? If not, what guidance should we provide? Alternatively, should listed issuers be required to disclose every restatement in Item 402(w)—even if recovery of excess incentive-based compensation is not required?

79. Should Item 402(w) disclosure be required even after an issuer has been delisted if it has not recovered all compensation under the policy?

80. Would the proposed Item 402(w) disclosure properly track any amount of incentive-based compensation subject to recovery through the duration of the recovery obligation until that amount either is recovered or the listed issuer concludes that recovery would be impracticable? If not, how should we revise the disclosure requirement to better track such amounts?

81. Is there any additional information that would be important to investors that should be disclosed?

82. Should the disclosure proposed by Item 402(w) of Regulation S–K be required only in annual reports and proxy and consent solicitations, as proposed? If not, please explain why. Should the disclosure of a listed issuer's application of its recovery policy be implemented by amending the executive compensation disclosure requirements of Item 402, as proposed? Alternatively, should it be implemented

[222] A foreign private issuer required to file annual reports with the Commission pursuant to Section 13(a) or Section 15(d) of the Exchange Act may file on Form 20–F or, if it elects to use the registration and reporting forms that U.S. issuers use, on Form 10–K. MJDS filers are those eligible Canadian reporting issuers that file registration statements and reports with the Commission in accordance with the requirements of the MJDS. MJDS filers file annual reports with the Commission pursuant to Section 13(a) or Section 15(d) of the Exchange Act on Form 40–F.

[223] If a foreign private issuer elects to use the registration and reporting forms that U.S. issuers use and files its annual report on Form 10–K, it is deemed to comply with Item 402 of Regulation S–K, an express form requirement of Form 10–K, by complying with Item 402(a)(1) of Regulation S–K. Therefore, we are also proposing to amend Item 402(a)(1) of Regulation S–K to include proposed Item 6.F of Form 20–F, which calls for the same disclosure as proposed Item 402(w).

[224] *See* Exchange Act Rule 3a12–3 (stating that securities registered by a foreign private issuer, as defined in Rule 3b–4, shall be exempt from sections 14(a), 14(b), 14(c), 14(f) and 16 of the Exchange Act).

[225] Form 20–F also sets forth disclosure requirements for registration statements filed by foreign private issuers under the Securities Act. Effective in 2000, the Commission incorporated in Form 20–F the International Equity Disclosure Standards, which were published by the International Organization of Securities Commissions (IOSCO). Release No. 33–7745 (Sept. 28, 1999) [64 FR 53900]. The disclosure requirements for related party transactions are set forth in Item 7.B of Form 20–F.

[226] The amendment would require a foreign private issuer that elects to provide domestic Item 402 disclosure to provide Item 402(w) disclosure in its annual report.

[227] Item 7.B requires a description of related party transactions for foreign private issuers.

[228] Proposed Instruction 4 to Item 7.B of Form 20–F.

[229] In general, foreign private issuers are required to submit Interactive Data Files, as defined in Rule 11 of Regulation S–T, to the Commission with their financial statements; however, those foreign private issuers that prepare their financial statements in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board are not required to submit Interactive Data Files until the Commission specifies on its Web site a taxonomy for use by such foreign private issuers in preparing their Interactive Data Files. *See Interactive Data to Improve Financial Reporting,* Release No. 33–9002 (Jan. 30, 2009) at n. 94 *http://www.sec.gov/rules/final/2009/33-9002.pdf. See also* Letter to the Center for Audit Quality (Apr. 8, 2011) at *http://www.sec.gov/divisions/corpfin/cf-noaction/2011/caq040811.htm.* We anticipate that foreign private issuers that do not yet submit a data file with their financial statements would have a similar accommodation for submitting proposed Item 6.F disclosure in a tagged format.

by amending the Item 407 corporate governance disclosure requirements, or by adopting a new Item of Regulation S–K? If so, please explain why.

83. Should a listed issuer only be required to provide the disclosure proposed by Item 402(w) in a report to its listing exchange or association, rather than in its annual reports and proxy and consent solicitations? If detailed notification is provided to its exchange or association, what type of disclosure, if any, should be made in a listed issuer's Commission filings? Alternatively, should a listed issuer be required to provide the proposed Item 402(w) disclosure and, in addition, be required to make a separate notification to its exchange or association?

84. How would the proposed Item 402(w) disclosure be used by institutional and retail investors, investment advisers, and proxy advisory firms in making voting decisions and recommendations on matters such as director elections and executive compensation?

85. Should we require that the disclosure required by proposed Item 402(w) be tagged in XBRL format, as proposed? Should we require a different format, such as, for example, eXtensible Markup Language (XML)? Would tagging these disclosures enhance the ability of shareholders and exchanges to assess issuers' compliance with their recovery policies? Alternatively, instead of requiring that either of these disclosures be tagged, should tagging this disclosure be optional?

86. Is the burden to implement the proposed tagging requirements comparatively greater for smaller reporting companies and emerging growth companies than for other issuers, such that we should exempt them or provide them a phase-in period for this requirement? If so, please explain the differential burden and how long a phase-in period it would justify.

87. We anticipate that foreign private issuers would not be required to submit an electronic data file with proposed Item 6.F disclosure until they submit financial statement information in an electronic data file. Is there a reason to require this information to be tagged before financial statement information is available in an electronic data file? What would the relative costs and benefits be of filing this information for the first time together or filing them separately?

88. Is the proposed instruction to Item 404(a), which would exclude a transaction involving recovery of excess incentive-based compensation that is disclosed pursuant to Item 402(w) from disclosure as a related party transaction, appropriate? Why or why not?

89. In the Summary Compensation Table, should any amount recovered pursuant to a listed issuer's recovery policy reduce the amount reported in the applicable column for the fiscal year in which the amount recovered initially was reported, as proposed? For example, with respect to equity awards, should the then-probable grant date fair value reported be reduced by the portion of that grant date fair value attributable to the number of shares or options recovered? Should this disclosure be required in any filing containing Summary Compensation Table disclosure? Should we require similar reductions in amounts reported in compensation tables required for registered management investment companies? Why or why not? Are there any special considerations relating to registered management investment companies that make disclosing this information more or less useful than similar disclosure by operating companies? If so, please describe.

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.

91. Is the disclosure proposed to be included in annual reports on Form N–CSR and proxy statements and information statements that mirrors the proposed disclosure in Item 402(w) appropriate for registered management investment companies subject to the rule? Should it be modified and, if so, how? Is it appropriate to include disclosure in both Form N–CSR reports and proxy statements and information statements? Should we, as proposed, amend General Instruction D to permit registered management investment companies to answer proposed Item 12 of Form N–CSR by incorporating by reference information from definitive proxy statements and definitive information statements? Why or why not? Should the proposed disclosure appear elsewhere in addition to, or in lieu of, reports on Form N–CSR and proxy and information statements, and, if so, where (*e.g.,* the Statement of Additional Information)? Should we require that registered management investment companies tag these disclosures in XBRL format, as proposed? Why or why not? Are there any special considerations relating to registered management investment companies that make tagging this information more or less useful than similar tagging by operating companies? If so, please describe.

92. Should listed foreign private issuers, including MJDS filers, be exempt from the requirement to provide disclosure about compensation recovery policies? If so, please explain why.

E. Indemnification and Insurance

State indemnification statutes, indemnification provisions in an issuer's charter, bylaws, or general corporate policy and coverage under directors' and officers' liability insurance provisions may protect executive officers from personal liability for costs incurred in a successful defense against a claim or lawsuit resulting from the executive officer's service to the issuer.[230] Commenters requested clarification about whether issuers may indemnify executive officers whose compensation is recovered due to no fault of their own.[231] If the Commission does not prohibit such arrangements, these commenters asserted that issuers should be required to disclose the existence of these agreements in their proxy statements and other filings.

We believe that indemnification arrangements may not be used to avoid or nullify the recovery required by Section 10(D). Section 10D's listing standard requirement that ''the issuer will recover'' is inconsistent with indemnification because a listed issuer does not effectively ''recover'' the excess compensation from the executive officer if it has an agreement, arrangement or understanding that it will mitigate some or all of the consequences of the recovery.[232]

[230] In the context of Securities Act registration statements, a registrant is required to ''state the general effect of any statute, charter provisions, by-laws, contract or other arrangements under which any controlling persons, director or officer of the registrant is insured or indemnified in any manner against liability which he may incur in his capacity as such.'' Item 702 of Regulation S–K.

[231] *See* letters from Towers Watson and Baker, Donelson, Bearman, Caldwell & Berkowitz, PC.

[232] *See Cohen* v. *Viray,* 622 F.3d 188, 195 (2d Cir. 2010) (holding that an indemnification agreement cannot be used to release chief executive officer and chief financial officer from liability to repay compensation under Section 304 of SOX, in part because ''indemnification cannot be permitted where it would effectively nullify a statute''); *see, also* Senate Report at 136 (''[I]t is unfair to shareholders for corporations to allow executives to retain compensation that they were awarded erroneously.''). To the extent that an issuer indemnifies an executive officer, arranges for or provides insurance protecting against the risk that incentive-based compensation will be recovered pursuant to the issuer's recovery policy, whether directly by purchasing this coverage or indirectly by increasing the executive compensation to facilitate the executive's purchase of this coverage, the executive officer retains the excess compensation to which he or she was not entitled.

Congress designed the recovery policy required by Section 10D to apply on a no-fault basis, requiring listed issuers to develop and implement a policy to recover ''any compensation in excess of what would have been paid to the executive officer had correct accounting procedures been followed.'' [233] Indemnification arrangements that permit executive officers to retain compensation that they were not entitled to receive based on restated financial statements fundamentally undermine the purpose of Section 10D.[234]

We further believe that Section 29(a) of the Exchange Act would render any indemnification agreement unenforceable to the extent that the agreement purported to relieve the issuer of its obligation under Section 10(D), the proposed rule and rule amendments, and a resulting listing standard to recover erroneously-paid incentive compensation. Section 29(a) provides that ''[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of a self-regulatory organization, shall be void.'' [235] As courts have noted, ''by its terms, Section 29(a) 'prohibits waiver of the substantive obligations imposed by the Exchange Act.' . . . . The underlying concern of this section is 'whether the [challenged] agreement weakens [the] ability to recover under the Exchange Act.' '' [236] Thus, we believe that Section 29(a) would not permit an indemnification agreement to undermine an issuer's right and obligation to recover excess incentive-based compensation.[237]

For these reasons, Rule 10D–1, as proposed, would prohibit a listed issuer from indemnifying any executive officer or former executive officer against the loss of erroneously awarded compensation.[238] Further, while an executive officer may be able to purchase a third-party insurance policy to fund potential recovery obligations, the indemnification prohibition would prohibit an issuer from paying or reimbursing the executive for premiums for such an insurance policy. For the reasons stated above, we believe that indemnification and insurance premium payment or reimbursement arrangements would frustrate Section 10D's ultimate purpose of preventing an executive officer from retaining compensation ''that the executive would not have received if the accounting was done properly and was not entitled to.'' [239]

Request for Comment

93. Should we require the exchanges to adopt listing standards that would prohibit issuers from indemnifying executive officers and/or funding the purchase of insurance to protect against the risk that an executive officer will be subject to the issuer's recovery policy, as proposed?

94. Should such listing standards also prohibit issuers from indemnifying executive officers' litigation expenses in recovery actions?

95. As noted above, the anti-indemnification provisions of Rule 10D–1 would prohibit agreements, arrangements or understandings that directly or indirectly mitigate some or all of the consequences of recovery. Will the exchanges and issuers be able to distinguish between payments that are made to mitigate the effect of a recovery and those that are paid as compensation in the ordinary course of business?

96. Should we define ''indemnification'' for purposes of the recovery under Section 10D? If so, how should it be defined? Should it require that there be an agreement on the part of the indemnitor in advance of the event for which the indemnitee is being indemnified?

F. Transition and Timing

We received a number of comments regarding timing and transition issues. Commenters generally advocated for prospective application of the recovery policy required by the listing standard. Commenters who addressed the application of Section 10D to former executive officers expressed concern about retroactive application to persons who were executive officers before Section 10D was enacted.[240] Some commenters recommended specific dates after which incentive-based compensation should be subject to recovery, such as the enactment date of the Act,[241] the effective date of the final implementing rules,[242] the effective date of the listing standards approved by the Commission,[243] or the date the issuer implements the listing standard.[244]

Commenters also expressed concerns regarding how the recovery policy would affect existing compensation contracts and agreements.[245] Commenters asserted that issuers may be unable to apply recovery policies retroactively to arrangements in which compensation already has been granted or earned, or to compensation provided pursuant to pre-existing employment agreements.[246] One commenter recommended that the Commission establish a grandfathering rule that would exempt incentive-based compensation awards granted before the effective date of the Commission's final rules implementing Section 10D.[247] Another commenter asked whether the recovery policy would apply to compensation paid from the date the policy is effective, regardless of contract terms, and when issuers would be required to make their recovery policies first enforceable.[248]

Additionally, some commenters suggested that the Commission provide for delayed compliance after the effective date of proposed Rule 10D–1 or approval of the listing standards, during which time issuers could develop and implement a recovery policy and make necessary plan amendments. These commenters recommended a 12-month period following Commission approval of the listing standards,[249] or a one-year period after the issuance of final rules,[250] for issuers to develop and implement their recovery policies and make any necessary plan amendments.

We propose that each exchange file its proposed listing rules no later than 90

[233] *See* Senate Report at 136.

[234] *Cf.* First *Golden Bancorporation* v. *Weiszmann,* 942 F.2d 726, 729 (10th Cir. 1991) (finding any attempt by a corporate insider to seek indemnity against liability for short-swing profits under Section 16(b) of the Exchange Act void as against public policy where Congress had a clear intent to provide a ''catch-all, prophylactic remedy, not requiring proof of actual misconduct.'').

[235] 15 U.S.C. 77cc. National securities exchanges and national securities associations are self-regulatory organizations. 15 U.S.C. 78c(a)(26).

[236] *AES Corp.* v. *The Dow Chemical Company,* 325 F.3d 174, 179 (3d Cir. 2003) (quoting *Shearson/American Express, Inc.* v. *McMahon,* 482 U.S. 220, 228, 230 (1987)).

[237] *See Cohen* v. *Viray,* 622 F.3d at 195 (citing Section 29(a) in rejecting indemnification against SOX § 304 liability); *Allied Artists Pictures Corp.* v. *Giroux,* 312 F. Supp. 450 (S.D.N.Y. 1970) (Section 29(a) rendered general release given by corporation to former chairman ''unenforceable as a matter of law'' in action by corporation to recover short-swing profits action under Section 16(b) of the Exchange Act).

[238] Proposed Rule 10D–1(b)(1)(v).

[239] *See* Senate Report at 135.

[240] *See* letters from Baker, Donelson, Bearman, Caldwell & Berkowitz, PC; Davis Polk & Wardwell; and Towers Watson.

[241] *See* letter from Compensia, Inc.

[242] *See* letter from Davis Polk & Wardwell LLP.

[243] *See* letter from Center on Executive Compensation.

[244] *See* letter from ABA Business Law Section.

[245] *See* letters from Baker, Donelson, Bearman, Caldwell & Berkowitz, PC, American Benefits Council and Towers Watson.

[246] *See* letters from ABA Business Law Section; American Benefits Council; and Davis Polk & Wardwell.

[247] *See* letter from American Benefits Council.

[248] *See* letter from Towers Watson.

[249] *See* letter from Center on Executive Compensation.

[250] *See* letter from American Benefits Council.

days following publication of the final adopted version of Rule 10D–1 in the **Federal Register**, and that its rules be effective no later than one year following that publication date,[251] and that each listed issuer shall adopt the recovery policy required by this section no later than 60 days following the date on which the exchanges' rules become effective.[252] We also propose that each listed issuer be required to recover all erroneously awarded incentive-based compensation received by executive officers and former executive officers as a result of attainment of a financial reporting measure based on or derived from financial information for any fiscal period ending on or after the effective date of Rule 10D–1 and that is granted, earned or vested on or after the effective date of Rule 10D–1 pursuant to the issuer's recovery policy.[253] Finally, we propose that a listed issuer be required to file the required disclosures in the applicable Commission filings required on or after the date on which the exchanges rules become effective.[254]

In light of the statutory purpose of Section 10D, we think it is appropriate to require exchanges to adopt listing standards that require issuers to comply with recovery policies that apply to incentive-based compensation that is based on or derived from financial information for periods that end on or after the effective date of Rule 10D–1. Issuer compliance would be required whether such incentive-based compensation is received pursuant to a pre-existing contract or arrangement, or one that is entered into after the effective date of the exchange's listing standard.

Request for Comment

97. Is the proposed schedule for exchanges to file their proposed listing rules and have them effective following the effective date of proposed Rule 10D–1 workable and appropriate? Similarly, is the proposal to require each listed issuer to adopt the required recovery policy within 60 days following the effective date of the exchanges' listing rules workable and appropriate? If not, what other schedule should apply?

98. Should the Commission provide that the recovery policy will apply to require recovery of all erroneously awarded incentive-based compensation received by a current or former executive officer on or after the effective date of Rule 10D–1 that results from attaining a financial reporting measure based on or derived from financial information for periods that end on or after the effective date of Rule 10D–1, as proposed? Alternatively, should the recovery policy apply to incentive-based compensation received by an executive officer on or after the effective date of the exchange's listing standard that results from attaining a financial reporting measure based on or derived from financial information for periods that end on or after the effective date of Rule 10D–1? If neither of these alternatives, what date(s) would be more appropriate and why? Should the Commission consider the date of compensation agreements and the ability of issuers to modify those agreements as part of the transition? If so, how?

99. Is there anything the Commission should do to address the potential effect proposed Rule 10D–1 will have on existing compensation plans and employment agreements that do not contemplate recovery under a policy required by the rule and rule amendments implementing Section 10D? To what extent will issuers need to amend their existing compensation plans and employment agreements to provide for the application of the recovery policy? Should the recovery policy only apply to new compensation plans and employment agreements entered into after the effective date of the exchange's listing standard? Why or why not?

100. As proposed, an exchange may not list an issuer that it has delisted or that has been delisted from another exchange for failing to comply with its recovery policy until it comes into compliance with that policy.[255] In this circumstance, should the exchange rules prohibit the issuer from obtaining a new listing at the same or a different exchange? Why or why not? If so, for how long?

101. Are there sufficient enforcement mechanisms to ensure compliance with the listing standard? Why or why not?

General Request for Comment

We request and encourage any interested person to submit comments on any aspect of our proposals, other matters that might affect the amendments, and any suggestions for additional changes. With respect to any comments, we note that they are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments and by alternatives to our proposals, where appropriate.

III. Economic Analysis

As discussed above, Section 954 of the Dodd-Frank Act amends the Exchange Act to include new Section 10D, which requires the Commission to direct the exchanges and associations to prohibit the listing of issuers that do not develop and implement policies to recover certain incentive-based compensation. The policies must provide that, in the event that the issuer is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws, the issuer will recover any compensation in excess of what would have been paid under the accounting restatement from any of its current or former executive officers who received incentive-based compensation during the three-year period preceding the date of the required restatement. Section 10D also calls for the listing standards to require each issuer to develop and implement a policy providing for disclosure of the issuer's policy on incentive-based compensation that is based on financial information required to be reported under the securities laws. We are proposing a new rule and rule amendments to satisfy the statutory mandates of Section 10D.

We have performed an analysis of the main economic effects that may flow from the rule and rule amendments being proposed today. We consider the economic impact—including the costs and benefits and the impact on efficiency, competition, and capital formation—of the proposed rule requirements on issuers and other affected parties, relative to the baseline discussed below.[256] We also consider the potential costs and benefits of reasonable alternative means of implementing Section 10D. Where practicable, we have attempted to quantify the effects of the proposed rule and rule amendments; however, in certain cases, we are unable to do so

[251] Proposed Rule 10D–1(a)(2)(i).

[252] Proposed Rule 10D–1(a)(2)(ii).

[253] *Id.*

[254] *Id.*

[255] Proposed Rule 10D–1(b)(1)(vi), described in Section II.C.2.c, above.

[256] Section 3(f) of the Exchange Act and Section 2(c) of the Investment Company Act require us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f); 15 U.S.C. 80a–2(c). Further, Section 23(a)(2) of the Exchange Act requires us, when proposing rules under the Exchange Act, to consider the impact that any new rule would have on competition and to not adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. *See* 15 U.S.C. 78w(a)(2).

because we lack the data necessary to provide a reasonable estimate.

We request comment on all aspects of the economic effects, including the costs and benefits of the proposals and possible alternatives. We also request comment on any effect the proposed requirements may have on efficiency, competition and capital formation. We appreciate comments that include both qualitative information and data quantifying the costs and the benefits identified in the analysis or alternative implementations of the proposed rule and rule amendments.

A. Baseline

The proposed rule and rule amendments require national securities exchanges and national securities associations to establish listing standards that would require each issuer to implement and disclose a policy providing for the recovery of erroneously paid incentive-based compensation. Consistent with Section 10D, the proposed rule and rule amendments require that the recovery of incentive-based compensation be triggered in the event the issuer is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws. In order to reduce the likelihood of a material accounting error, executive officers may have an enhanced incentive to ensure that greater care is exerted in preparing accurate financial reports, or a reduced incentive to engage in inappropriate accounting practices for the purpose of increasing incentive-based compensation awarded to them.[257] While these incentives could result in high-quality financial reporting that would benefit investors, they may also alter operating decisions of executive officers or divert resources away from activities that may involve more complex accounting judgments.

The proposed requirement that an issuer implement a recovery policy would introduce uncertainty about the amount of incentive-based compensation the executive officer will be able to retain. As a result, executive officers may demand that incentive-based compensation comprise a smaller portion of their pay packages, or that they receive a greater total amount of compensation, to account for the possibility that the awarded incentive-based compensation may be reduced due to future recovery. With these possible changes to the pay packages of executive officers, overall executive compensation may become less sensitive to the performance of the issuer, and the interests of the executive officers could diverge from those of the shareholders. Further, to the extent that executive officers respond negatively to the expected effects of the compensation recovery policies developed and implemented by issuers, the proposed rule and rule amendments may cause affected issuers to be less able to attract and retain executive talent, when competing for that talent against unlisted companies. We note that there may be other factors affecting the ability of an issuer to attract and retain executive talent. Further, the incremental effect of the proposed rule and rule amendments is mitigated to the extent that the labor markets for executives at listed issuers and at unlisted issuers do not overlap.

To assess the economic impact of the proposed rule and rule amendments, we are using as our baseline the current state of the market without a requirement for listed issuers to implement and disclose a compensation recovery policy consistent with Section 10D.

The proposed rule and rule amendments would dictate listing standards that require the recovery of excess incentive-based compensation that is based on financial reporting measures, including stock price and total shareholder return (''TSR''). Performance-based compensation can be either short-term or long-term, and each type can potentially be tied to different measures of performance. One study[258] found that, in the short-term incentive plans of chief executive officers (CEOs) at S&P 1500 companies in 2012, the three most common financial reporting measures used as performance metrics were earnings (36 percent), revenue (27 percent), and operating income (26 percent). In contrast, in long-term incentive plans, the three most common financial reporting measures used to compensate CEOs were TSR (48 percent), earnings (31 percent), and revenue (17 percent).[259] While earnings also was frequently used as a performance measure in long-term incentive plans, TSR was the most frequent metric used for such plans. The use of TSR was far less prevalent in short-term incentive plans, where only 10 percent of plans used it.[260] Based on Commission staff analysis of 145 randomly sampled issuers drawn from the full population of firms (both domestic and foreign) that filed an annual proxy statement in calendar year 2013, we estimate that approximately 21 percent of issuers used stock price and/or TSR as an element of their performance-based compensation.[261]

Under the proposed rule and rule amendments, the trigger for the recovery of excess incentive-based compensation would be when the issuer is required to prepare an accounting restatement as the result of a material error that affects a financial reporting measure based on which executive officers received incentive-based compensation. Hence, not all accounting restatements would trigger a recovery of compensation that was earned as a result of meeting performance measures. Using incentive-based compensation tied to revenue as an example, in order for that compensation to be required to be recovered, there would have to be a material accounting error that affects revenue. Based on one recent study, only 15 percent of all Item 4.02-reported accounting restatements made between 2005 and 2012 were due to errors involving revenue.[262] If the issuers that

[257] We note that not all executive officers affected by the proposed rule and rule amendments may have the ability to directly affect the financial reporting of the issuer.

[258] *See* Equilar *Measuring Short-Term and Long-Term Performance in 2012* (May 28, 2013), available at *http://www.equilar.com/publications/26-measuring-short-term-and-long-term-performance-in-2012.html.*

[259] *See* Equilar *Measuring Short-Term and Long-Term Performance in 2012* (May 28, 2013).

[260] Performance-based compensation may be tied to multiple measures of performance. The average number of performance measures to evaluate performance in the short-term and long-term is 1.8 and 1.7, respectively. *See* Equilar *Measuring Short-Term and Long-Term Performance in 2012* (May 28, 2013).

[261] We estimated the percentage of issuers that use stock price and/or TSR as performance metrics based on Commission staff analysis of information disclosed in annual proxy statements (DEF 14A). The sample comprises 145 proxy filers, which represents about 3 percent of the total number of DEF 14A filers in calendar year 2013. Staff manually examined the CD&A in each of the 145 proxy statements to find that 21 percent of the 145 randomly sampled issuers disclosed the use of stock price and/or TSR as compensation performance metrics in 2013. Another 30 percent of the 145 randomly sampled issuers do not disclose whether they use compensation performance metrics; however, if these companies use stock price and/or TSR as a compensation performance metric, it is likely not a material element of their compensation because Item 402 of Regulation S–K calls for disclosure in the CD&A if a performance target is a material element of compensation policies and practices.

[262] *See* Scholz, S. 2013. ''Financial Restatement: Trends in the United States: 2003–2012.'' Center for Audit Quality, available at: *http://thecaq.org/reports-and-publications/financial-restatement-trends-in-the-united-states-2003-2012/financial-restatement-trends-in-the-united-states-2003-2012*. In referring to findings of the study, we use the phrase *Item 4.02-reported accounting restatement* when the issuer filed an Item 4.02 to Form 8–K in connection with such restatement. The study characterizes these as ''4.02 restatements'' and observes that the filing of Item 4.02 to Form 8–K is required when an accounting error renders

Continued

had a material accounting error in revenue had been subject to the proposed rule requirements, those issuers that awarded incentive-based compensation tied to the restated revenue or other measures that are affected by the restatement of revenue would be required to recover the incentive-based compensation paid to executive officers.[263]

Further, the incidence of events where incentive-based compensation would be required to be recovered is affected by the number of restatements based on material errors that occur. A recent study reports that between 2005 and 2012 there was an average of 531 Item 4.02-reported accounting restatements per year, but the incidence of accounting restatements steadily declined over this period.[264] In calendar year 2012, there were 255 Item 4.02-reported accounting restatements, which represent approximately three percent of the population of issuers that potentially could have had an Item 4.02-reported accounting restatement.[265] This suggests that an event that would require an issuer to recover compensation (*i.e.,* payment of incentive-based compensation tied to a financial reporting measure *and* occurrence of a material accounting error) would be relatively infrequent.[266]

The proposed rule and rule amendments would require exchanges to apply the compensation recovery requirement to all listed issuers, including emerging growth companies (EGCs), smaller reporting companies (SRCs), foreign private issuers (FPIs), and controlled companies. We estimate that proposed Rule 10D–1 would be applicable to 4,845 registrants.[267] We estimate that, of those 4,845 registrants, there are 706 SRCs, 376 EGCs, 511 FPIs (filing annual reports on Form 20–F), and 128 MJDS issuers (filing annual reports on Form 40–F). There are a limited number of registered management investment companies that also would be affected by the proposed rule and rule amendments. We estimate that there are approximately seven registered management investment companies that are listed issuers and are internally managed, that may have executive officers who receive incentive-based compensation.

As outlined in the table below, we estimate that approximately 23 percent of all filers currently disclose some form of an executive compensation recovery policy.[268] We further estimate that approximately four percent of SRCs, two percent of EGCs, three percent of FPIs, and one percent of MJDS issuers disclose some form of a recovery policy.

	Number of filers that disclose a recovery policy	Number of filers affected (total)	Percent of filers that disclose a recovery policy
All affected filers (total)	1,116	4,845	23.0
SRCs	29	706	4.1
EGCs	9	376	2.4
FPIs	17	511	3.3
MJDS	1	128	0.8
All other filers	1,060	3,124	33.9

We note that larger issuers are more likely to have already implemented and disclosed a recovery policy. Using the staff estimates discussed above, as of June 30, 2014, approximately 64 percent (305 issuers) of the issuers that comprise the S&P 500 and approximately 50 percent (713 issuers) of the issuers that comprise the S&P 1500 report having a recovery policy of some form.[269]

In addition to the issuers referenced above, some issuers may have experience with recovering executive compensation given existing provisions of law concerning the recovery of such compensation under certain circumstances. Section 304 of SOX contains a recovery provision that is triggered when a restatement is the result of issuer misconduct. This provision applies only to CEOs and chief financial officers (''CFOs'') and the amount of required recovery is limited to compensation received in the 12-month period following the first public issuance or filing with the Commission of the improper financial statements.[270] In addition, the Interim Final Rules under Section 111 of EESA, as amended by ARRA, required institutions receiving assistance under TARP to mandate that Senior Executive Officers and the next twenty most highly compensated employees repay compensation if awards based on statements of earnings, revenues, gains,

previously-filed financial statement unreliable. The study also comments that these are generally more serious than other restatements, which it refers to as ''non-4.02 restatements.''

[263] Incentive-based compensation tied to financial reporting measures that are affected by more reported items on the financial statements is more likely to be recovered. For example, incentive-based compensation tied to earnings or operating income is more likely to be recovered because material accounting errors that involve either revenue or expenses could impact these measures and thereby trigger a required recovery. Between 2005 and 2012, 52 percent of significant restatements involved operating expenses. *See* Scholz, S. 2013. ''Financial Restatement: Trends in the United States: 2003–2012.'' Center for Audit Quality.

[264] *See* Scholz, S. 2013. ''Financial Restatement: Trends in the United States: 2003–2012.'' Center for Audit Quality.

[265] In calendar year 2012, approximately 8,000 registrants filed annual reports on Form 10–K and would be required to file Item 4.02 to Form 8–K. We note that the proposed rule and rule amendments would affect a subset of registrants subject to reporting on Form 8–K (*i.e.,* the listed issuers).

[266] These estimates are based on historical rates and types of restatements, which may not be indicative of future rates and types of restatements.

[267] We estimate the number of issuers subject to the proposed rule based upon Commission staff analysis of issuers that filed annual reports on Form 10–K, Form 20–F, or Form 40–F pursuant to Section 12(b) of the Exchange Act in the period from 7/1/2013 to 6/30/2014, regardless of the fiscal year of the filing. The staff used text analysis of an issuer's Form 10–K to determine if the issuer is an SRC. The staff performed a similar analysis of an issuer's Form 10–K and registration statement to determine if the issuer is an EGC. Examining filings in this manner involves a certain degree of error, and it is possible for issuers to be misclassified. Hence all numbers in this analysis should be taken as estimates.

[268] We estimate the number of issuers that have disclosed some form of recovery policy based on Commission staff analysis of information disclosed in Form 10–K, Form 20–F, Form 40–F, and an issuer's annual proxy statement (DEF 14A). Staff used text analysis and keyword searches similar to those of Babenko, Bennett, Bizjak, and Coles in their working paper *Clawback Provisions* (2012) available at *http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2023292.* Examining filings in this manner involves a certain degree of error, and it is possible for issuers to be misclassified. Hence all numbers in this analysis should be taken as estimates.

[269] A report by Equilar finds that the prevalence of recovery policies in Fortune 100 companies has increased from less than 18 percent in 2006 to 84 percent in 2011 and more than 89 percent in 2013. *See* Equilar *Clawback Policy Report* (2013), available at *http://info.equilar.com/rs/equilar/images/equilar-2013-clawbacks-policy-report.pdf.* This increasing trend in the implementation of recovery policies is supported by Babenko, Bennett, Bizjak, and Coles in their working paper *Clawback Provisions* (2012).

[270] *See* 15 U.S.C. 7243.

or other criteria were later found to be materially inaccurate.[271] As discussed above, relative to either SOX or EESA, the compensation recovery requirement of the proposed rule and rule amendments has a different scope because it would affect any current or former executive officer of all listed issuers and would be triggered when the issuer is required to prepare an accounting restatement due to material noncompliance of the issuer with any financial reporting requirement under securities laws, regardless of issuer or executive misconduct or the role of the executive in preparing the financial statements. Finally, we note that currently issuers other than SRCs, EGCs, and FPIs are required to disclose in the CD&A, if material, their policies and decisions regarding adjustment or recovery of named executive officers' compensation if the relevant performance measures are restated or adjusted in a manner that would reduce the size of an award or payment.[272]

Many of the issuers that disclose having recovery policies do not require misconduct on the part of the executive to trigger recovery.[273] In a review by Commission staff[274] of a random sample of 104 issuers with disclosed recovery policies, 51 issuers (49 percent) did not require misconduct on the part of the executive, 34 issuers (33 percent) required misconduct on the part of the executive, and 19 issuers (18 percent) did not specify. By contrast, the proposed rule and amendments would require all listed issuers to have a recovery policy that applies to any material accounting error, without regard to misconduct.

There appears to be considerable variation in the coverage of employees subject to recovery under currently disclosed recovery policies.[275] Under the proposed rule and rule amendments, a listed issuer's compensation recovery policy would require recovery of excess incentive-based compensation received by an individual who served as an executive officer of the issuer at any time during the performance period for that incentive-based compensation. As a result, in some cases recovery would be required from individuals who may be former executive officers either at the time they receive the incentive-based compensation or at the date when the listed issuer is required to prepare an accounting restatement. In a review by Commission staff of the random sample of 104 issuers with disclosed recovery policies noted above, the recovery policies of 82 issuers (79 percent) applied to any current executive officer; and only three of those 82 issuers had recovery policies that applied to former executive officers.[276] Therefore, the majority of issuers examined disclose having recovery policies that require compensation recovery from a narrower range of individuals than a recovery policy that would comply with the proposed rule requirements.

The type and scope of compensation subject to recovery in currently disclosed recovery policies also appears to vary across issuers. In the staff's review of a random sample of 104 issuers that disclosed recovery policies, the recovery policies of 64 issuers (62 percent) applied to any form of performance-based compensation, and thus would satisfy the requirements of the proposed rule in this regard. Further, out of the 104 issuers with disclosed recovery policies, 29 issuers (28 percent) specified that only the excess performance-based compensation was subject to recoupment, while 47 issuers (45 percent) specified that all of the performance-based compensation was potentially recoverable.[277] Considered together, 76 of the 104 issuers (73 percent) examined may already have a recovery policy that covers excess incentive-based compensation as would be required by the proposed rule and rule amendments.

Moreover, 94 issuers (90 percent) specified either a look-back period of three years or did not specify a look-back period, which we interpret as having a potentially indefinite look-back period. Accordingly, a majority of the current policies the staff reviewed have a look-back period that is the same length or longer than the look-back period required in a recovery policy that would comply with the proposed rule requirements. We note, however, that due to the limited disclosure available in public filings, the staff was unable to determine if the start and end dates of the look-back window would cover the proposed required look-back period in the proposed rule. The results of this random sample indicate that, for issuers with disclosed recovery policies, the majority may already include look-back provisions consistent with the requirements under the proposed rule and rule amendments.

In summary, the staff's review of the disclosed recovery policies of 104 issuers found:

Proposed requirements	Existing policies
The recovery policy is "no fault" in nature	51 of the 104 policies examined do not require misconduct on the part of the executive.

[271] Under EESA a "Senior Executive Officer" is defined as an individual who is one of the top five highly paid executives whose compensation is required to be disclosed pursuant to the Securities Exchange Act of 1934. *See* Department of Treasury, TARP Standards for Compensation and Corporate Governance; Interim Final Rule (June 15, 2009), available at *http://www.gpo.gov/fdsys/pkg/FR-2009-06-15/pdf/E9-13868.pdf.*

[272] *See* Item 402(b)(2)(viii).

[273] In a sample of 2,326 companies in the Corporate Library database, DeHaan et al. (2013) find that 39 percent had compensation recovery policies that did not require executive misconduct in order to be triggered. DeHaan, Hodge, and Shevlin *Does Voluntary Adoption of a Clawback Provision Improve Financial Reporting Quality?* Contemporary Accounting Research 30 (2013) 1027–1062.

[274] In the staff review, 104 issuers out of the 1,116 issuers that disclosed a recovery policy in the period 7/1/2013 to 6/30/2014 were randomly selected for an in depth examination of their recovery policies. Each recovery policy disclosure was read, or if the recovery policy was incorporated by reference, the original disclosure was read. Staff examined each policy for (1) which employees were covered, (2) what type of compensation was at risk for recovery, (3) how much of that compensation was at risk for recovery, (4) what type of event or events triggered a recovery action, (5) if misconduct was required for a recovery action, and (6) the timing of the window for which compensation was at risk for recovery. The characterization of these policies, as set forth below, is based on limited information available from public filings and may involve some interpretation of otherwise ambiguous terms and conditions. Hence, all numbers presented should be taken as estimates.

[275] As of 2013 approximately 61 percent of S&P Fortune 100 companies had recovery policies that applied to key executives and employees including named executive officers; approximately 13 percent applied to all employees; approximately seven percent applied to just the CEO and/or CFO; and the remainder did not have a recovery policy or did not specify coverage. *See* Equilar *Clawback Policy Report* (2013).

[276] Of the remaining 22 issuers in the sample, the recovery policies of two applied to CEOs, two applied to both the CEO and CFO, one applied to the COO, and 17 did not specify to whom the recovery policy applied. From the current disclosure in public filings, the staff generally could not determine whether the definition of "executive officers" that issuers use for purposes of their compensation recovery policies is consistent with the definition of "executive officer" in the proposed rule and rule amendments. A subset of issuers specified that only named executive officers were covered, while others specified senior executives, executive officers, or employees vice-president and above. For purposes of this baseline discussion, we include these employees in the category "executive officer."

[277] As discussed above, the characterization of these policies is based on limited information available from public filings and may involve some interpretation of otherwise ambiguous terms and conditions. Hence, all numbers presented should be taken as estimates.

Proposed requirements	Existing policies
Former executive officers are covered	101 of the 104 policies examined do not disclose that former executive officers are covered.
Excess incentive-based compensation based on attainment of a financial reporting measure is recoverable	64 of the 104 policies examined apply to any form of performance-based compensation. 76 of the 104 policies examined may already allow for excess incentive-based compensation to be recovered.
Policy has a three year look-back period	94 of the 104 policies examined may already have a look-back period of three years or longer.

B. Analysis of Potential Economic Effects

The discussion below analyzes the economic effects of the proposed rule and rule amendments, including the anticipated costs and benefits as well as the likely impact on efficiency, competition, and capital formation. For purposes of this analysis, we address the potential economic effects resulting from the statutory mandate and from our exercise of discretion together, recognizing that it is often difficult to separate the costs and benefits arising from these two sources. Below we discuss the potential effects of the proposed rule and rule amendments on financial reporting quality, on executive compensation packages, on listed issuers, and on U.S. exchanges. We also discuss the potential effects arising from the proposed rule's prohibition on indemnification and payment or reimbursement of premiums for insurance against recovery.

1. Potential Effects on Financial Reporting

In seeking to maximize the value of their financial investments, shareholders rely on the financial reporting quality of issuers to make informed investment decisions about the issuer's securities. High-quality financial reporting should provide shareholders with an accurate estimate of the issuer's performance and should be informative about its firm value.[278] An accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws may cause shareholders to question the accuracy of those estimates and may lead shareholders and other prospective investors to substantially revise their beliefs about the issuer's financial performance and prospects with potentially significant effects on firm value.

While incentive-based compensation is typically intended to provide incentives to executives to maximize the value of the enterprise, thus aligning their incentives with shareholders, it may also provide executives with incentives that conflict with shareholders' reliance on high-quality financial reporting. In particular, when setting the compensation for executives, the board of directors of an issuer may seek to align the interests of executives with those of the shareholders by tying executive compensation to financial reporting measures that the board believes will have a positive effect on firm value. To the extent that executives are in a position to affect the preparation of financial statements, this approach can, however, create the incentive for executives to influence the preparation of financial statements and related filings in ways that appear to achieve those measures. For example, certain financial performance measures require estimates and judgments, and if those estimates and judgements are influenced by the performance incentives that are part of the executive compensation packages, then the reported performance of the issuer may not reflect actual enhancement to firm value.

In some instances, executives might have incentives to pursue impermissible accounting methods under GAAP that result in a material misstatement of financial performance.[279] This potential for *deliberate* misreporting raises a principal-agent problem that is detrimental for shareholders.[280] Although civil and criminal penalties already create disincentives to deliberate misreporting, the recovery requirements under the proposed rule and rule amendments would reduce the financial benefits to executive officers who choose to pursue impermissible accounting methods, and thus may add another disincentive to engage in deliberate misreporting. The magnitude of this effect would likely depend on the particular circumstances of an issuer.

The proposed rule and rule amendments may also provide executives with an increased incentive to take steps to reduce the likelihood of *inadvertent* misreporting. Most directly, the executive may have the ability to reduce the uncertainty in her compensation by devoting more resources to the production of high-quality financial reporting, thereby reducing the likelihood of a material accounting error. For example, an executive could devote more labor or internal capital to strengthening internal controls over financial reporting. One study[281] found that, after the implementation of a recovery policy, an auditor is less likely to report a material weakness in an issuer's internal controls over financial reporting, which is consistent with issuers devoting more resources to internal controls over financial reporting.

Executives may also take other steps to reduce the likelihood of an inadvertent misreporting. An executive could change the business practices of the issuer, thereby affecting the opportunity for a material accounting error to arise. For example, an executive could simplify delivery terms of a project or a transaction in order to use accounting standards that are more straightforward to apply and perhaps require fewer accounting judgments,

[278] For purposes of this economic analysis, high-quality financial reporting means when financial disclosure is informative about the actual performance of the issuer.

[279] We also note that some estimates and judgments permissible under GAAP may allow executives to realize higher compensation, without resulting in a material misstatement of financial performance and thus without triggering recovery consistent with Section 10D.

[280] Among other decisions, executives must decide the extent of internal resources and personal attention to devote to achieving high-quality financial reporting and assuring that the financial disclosure is informative about the performance of the issuer. Given that the expected costs and benefits associated with any level of investment decision in financial reporting quality would ultimately be reflected in the issuer's firm value, in absence of a principal-agent problem, executives would likely decide to allocate the value maximizing amount of resources to producing high-quality financial statements and, as a result, the level of information value of the financial reporting would likely be optimal. A principal-agent problem, however, reduces the executive's incentive to allocate the appropriate amount of resources to produce high-quality financial statements, which reduces the information value of financial reporting.

[281] *See* Chan, Chen, Chen, and Yu *The effects of firm-initiated clawback provisions on earnings quality and auditor behavior* Journal of Accounting and Economics 54 (2012) 180–196.

which may reduce the likelihood of material accounting errors.[282] Taking steps such as these does not necessarily affect the selection of the project or transaction the issuer chooses to undertake (although it could, as discussed below), but could result in greater investor confidence in the quality of financial reporting and information value of the financial statements, and thus have a positive impact on capital formation.[283]

As a result of the proposed rule and rule amendments, we believe that the increased incentives to generate high-quality financial reporting may improve the overall quality of financial reporting. An increase in the quality of financial reporting could result in increased informational efficiency, enhanced investor confidence that may result in greater market participation, and a reduced cost of raising capital, thereby facilitating capital formation. While we lack the data to quantify the potential benefits to shareholders from a reduced likelihood of a material accounting error, evidence suggests that penalties imposed by the market for accounting restatements are likely to be substantial.[284] For example, one recent study [285] found that over the period 2005 to 2012 the market value of equity of the average issuer declined by 2.3 percent upon announcement of a significant financial restatement.[286]

More broadly, the availability of more informative or accurate information regarding the financial performance of issuers would also have the effect of increasing the efficient allocation of capital among corporate issuers. Because investors would be better informed about the potential investment opportunities at any given point in time, they would be more likely to allocate their capital according to its highest and best use. This would benefit all issuers, even those whose financial reporting would not be affected by the proposed rule requirements on exchanges' listing standards. In particular, issuers whose financial reporting is unaffected may have better access to capital by virtue of investors being able to make more informed comparisons between them and issuers whose financial reporting would become more accurate as a result of the proposed rule requirements.[287] In contrast, without the proposed rule and rule amendments, investors may improperly assess the value of the issuers whose financial reporting is based on erroneous information, which could result in an inefficient allocation of capital, inhibiting capital formation and competition.

We are aware, however, that these potential benefits of the proposed rule and rule amendments are not without associated costs. Under the proposed rule and rule amendments, the increased allocation of resources to the production of high-quality financial reporting may divert resources from other activities that may be value enhancing. Moreover, while the increased incentive to produce high-quality financial reporting and thus reduce the likelihood of material accounting errors should increase the informational efficiency of investment opportunities, it may also encourage executives to forgo value-enhancing projects if doing so would decrease the likelihood of a financial restatement.[288] For example, when choosing among investment opportunities for the issuer, executives may have less incentive to pursue those projects that would require more complicated accounting judgments, so as to reduce the likelihood of an unintentional but material accounting error.[289] That is, the proposed rule and rule amendments may create an incentive for an executive to forgo projects for which it is more difficult to generate high-quality financial reporting.[290] This could have an adverse impact on the value of the issuer to the extent that the foregone projects would have resulted in greater value than those that were ultimately chosen.

One study suggests that a compensation recovery policy could result in an increased likelihood of an executive making suboptimal operating decisions in order to affect specific financial reporting measures as a result of the decreased incentive to use accounting judgments to affect those financial reporting measures.[291] For example, if an executive is under pressure to meet an earnings target, rather than manage earnings through

[282] For example, the executive could make accounting judgments on loan loss reserves or expected returns on sales with complicated returns criteria that are less likely to result in an accounting restatement.

[283] An academic study shows that, when market competition is weak, the information environment affects the expected returns of equity securities. In particular, when financial disclosure quality is low, as measured by scaled accruals quality, companies with low market competition, as measured by the number of shareholders of record, have a higher expected return. All else being equal, higher expected returns make raising capital more costly for the company. *See* Armstrong, Core, Taylor, and Verrecchia *When Does Information Asymmetry Affect the Cost of Capital* Journal of Accounting Research Vol. 49 No. 1 March 2011. The academic literature has developed a measure of the quality of financial reporting denoted accruals quality. This measure quantifies how well accruals are explained either by the cash flow from operations (past, current, and future periods) or accounting fundamentals. For details on the construction and interpretation of the measure *see* Dechow and Dichev *The Quality of Accruals and Earnings: The Role of Accrual Estimation Errors* The Accounting Review, Vol. 77, Supplement 2002 pp. 35–39; and Francis, LaFond, Olsson, and Schipper *The market pricing of accruals quality* Journal of Accounting and Economics 29 (2005) 295–327.

[284] These penalties would likely include both revaluation and reputational effects, where the two types of effects are often difficult to separate.

[285] *See* Scholz, S. 2013. ''Financial Restatement: Trends in the United States: 2003–2012.'' Center for Audit Quality.

[286] In the 2005–2012 period, the average issuer paid approximately 0.48 percent of its market value of equity to all named executive officers in the form of non-salary compensation during that time period. Non-salary compensation data is from Standard and Poor's Executive Compensation database which tracks compensation for the companies currently or previously in the S&P 1500 index. Moreover, this comparison is inexact, because the proposed rule would require the recovery of only *excess* incentive-based compensation, and not all non-salary compensation, thereby reducing the percentage of market value paid to executives. The proposed rule and rule amendments would however, also require a recovery policy that applies to more than just the named executive officers, thereby increasing the percentage of market value paid to executives.

[287] *See* Bushee and Leuz *Economic consequences of SEC disclosure regulation: evidence from the OTC bulletin board* Journal of Accounting and Economics 39 (2005) 233–264.

[288] Projects that increase the volatility of cash flows from operations, the volatility of sales revenue, or percentage of soft assets have been associated with an increased likelihood of an SEC enforcement action (specifically, the likelihood of an issuer being the subject of a SEC Accounting and Auditing Enforcement Release). *See* Dechow and Dichev *The Quality of Accruals and Earnings: The Role of Accrual Estimation Errors* The Accounting Review, Vol. 77, Supplement 2002 pp. 35–39; Dechow, Ge, Larson, and Sloan *Predicting Material Accounting Misstatements* Contemporary Accounting Research Vol. 28 No. 1 (Spring 2011).

[289] For example, the issuer could select projects that do not add to the complexity of the required reporting systems, or select projects that have a shorter performance period and therefore may involve less difficult accounting judgments about the expected future costs.

[290] Babenko et al find that after the implementation of a compensation recovery policy, issuers spend less on research and development, file for fewer patents, and hold more cash. This is consistent with executives changing their project selection policy as the result of implementing a compensation recovery policy. *See* Babenko, Bennett, Bizjak, and Coles *Clawback Provisions* Working Paper (2015). We note, however, that the determination of whether or not to select a particular project is likely related to many characteristics of the project. These characteristics could include the value the project creates, the cash flows the project returns in the near term, and the strategic objectives of the issuer.

[291] Chan, Chen, Chen, and Yu document that after the implementation of a compensation recovery policy issuers reduce accruals manipulation but increase real transaction management. They further document that the increase in real transaction management results in improved short-term performance, as measured by changes in return on assets, but diminished long-term performance. In the context of their study, real transaction management is when executive officers structure operating decisions to affect reported financial performance. *See* Chan, Chen, Chen, and Yu *The effects of firm-initiated clawback provisions on earnings quality and auditor behavior* Journal of Accounting and Economics 54 (2012) 180–196.

accounting judgments, an executive may elect to reduce or defer to a future period research and development or advertising expenses. This could improve reported earnings in the short-term, but could result in a suboptimal level of investment that adversely affects performance in the long run. The study also documents that the propensity of executives to undertake such actions may be particularly high in issuers that are characterized as having strong growth opportunities.[292] The incentive to use operating decisions to affect financial reporting measures could be partially mitigated to the extent that the board's compensation committee would expect this behavior after the implementation of a recovery policy and construct metrics that take into account the possibility of such actions. They might also design internal controls to detect such actions, such as rigorous budget variance analyses.

Under the proposed rule and rule amendments, if it appears that previously filed financial statements may contain a material accounting error, there may also be an incentive for issuers or individual executives (to the extent they are in a position to do so) to cause the company to delay investigating the error or to characterize as immaterial an accounting error that would otherwise be properly characterized as material. The incentive to delay is present because only excess incentive-based compensation received in the three fiscal years prior to the determination of a material accounting error is subject to recovery under the proposed rule and rule amendments.[293] The incentive to characterize an accounting error as immaterial that would otherwise properly be characterized as material is present because compensation recovery is only required after the conclusion a material accounting error exists.[294] To the extent that these incentives discourage the timely and accurate reporting of material accounting errors, it could result in loss of confidence in financial information disclosures by investors and hinder capital formation.

These incentives to delay the conclusion that a restatement is necessary or to mischaracterize material accounting errors are mitigated, however, by several factors. For example, the proposed definition of the date on which an issuer is required to prepare an accounting restatement, which is the date on which the issuer concludes, or reasonably should have concluded, that the issuer's previously issued financial statements contain a material error would provide an objective basis for assessing when the required three year look-back period begins. Moreover, the potential for the issuer and individual executives to incur additional legal liability, including potential criminal prosecution, for the deliberate or negligent delay in investigating and reporting a material accounting error or mischaracterization of an accounting error, combined with the likelihood that such conduct would be detected,[295] may offset the incentives arising from the required three year look-back period prior to the determination of a material accounting error.

2. Potential Effects on Executive Compensation

When setting the compensation for executives, the board of directors of an issuer frequently incorporates into the total compensation package a payout that is tied to one or more measures of the issuer's performance. The purpose of tying compensation to performance is to provide an incentive for executives to maximize the value of the enterprise, thus aligning their incentives with other shareholders. The proportion of the pay package that relies on performance incentives generally depends on factors such as the level of risk inherent in the issuer's business activities, the issuer's growth prospects, and the scarcity and specificity of executive talent needed by the issuer. It also may reflect personal preferences influenced by characteristics of the executive such as age, wealth, and aversion to risk. In particular, the executive's risk aversion may make pay packages with strong performance incentives undesirable because of the less predictable payments. These factors contribute not only to the magnitude of the expected compensation, but also to how an executive views and responds to the compensation.[296]

We anticipate that the requirements of the proposed rule and rule amendments could meaningfully affect the size and composition of the compensation packages awarded to executives of listed issuers. As noted above, risk averse executives prefer predictable compensation, and the mandatory implementation of a recovery policy that meets the requirements of the proposed rule and rule amendments would introduce an additional source of uncertainty in the compensation of the executive. Moreover, because the mandated recovery policy would be required to be ''no-fault'' in nature, the occurrence of a material accounting error would require executives to return excess incentive-based compensation even if they had no role in the material accounting error. A recovery policy would, therefore, introduce uncertainty in the amount of incentive-based compensation that executives will ultimately retain, with those executives less directly involved with financial reporting incurring relatively more uncertainty.

For executives who already have established compensation packages, the proposed rule and rule amendments may create an incentive to negotiate changes to their composition.[297] In particular, because of the increased uncertainty, risk averse executives may lower the value that they attach to the incentive-based component of their pay and may as a result demand an offset to bear the increased uncertainty. The offset could come in the form of a smaller portion of pay being comprised of incentive-based compensation,[298] which could weaken incentive alignment, *i.e.,* pay-for-performance sensitivity,[299] or through an increase in expected total compensation, which would come at a greater cost to the

[292] *Id.*

[293] For example, suppose that in November 2015 an issuer with a fiscal year ending in December suspects that there is a material accounting error in its financial statements. Further, suppose that the executives of the issuer had received a large incentive-based compensation award in 2012. If the issuer investigates immediately and concludes in November 2015 that there was a material accounting error, then incentive-based compensation received in 2012 is at risk for recovery. The issuer might choose to delay its investigation until 2016 in order to avoid this result.

[294] *See* Files, Swanson, and Tse *Stealth Disclosure of Accounting Restatements* The Accounting Review 84 (2009), 1495–1520; Myers, Scholz, and Sharp *Restating Under the Radar? Determinants of Restatement Disclosure Choices and the Related Market Reactions* Working Paper (2013), available at: *http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1309786&download=yes.*

[295] Outside auditors' oversight may play as an additional mitigating factor.

[296] Executives typically have personal preferences regarding the form of compensation received. To the extent that executives have different levels of risk aversion, they can arrive at different personal valuations of the same performance-based compensation package. Hence, more risk-averse executives may require additional compensation when paid in the form of less certain performance-based compensation.

[297] *See* letters from Stuart R. Lombardi and Towers Watson.

[298] We note that, if the offset comes as a reduced weight placed on incentive-based compensation, the recoverable funds if a material accounting error occurs would be reduced.

[299] Pay-for-performance sensitivity is a measure of incentive alignment used in academic research. The measure captures the correlation of an executive officer's compensation with changes in shareholder wealth. *See, e.g.,* Jensen and Murphy, Journal of Political Economy, Vol. 98, No. 2 (Apr., 1990), pp. 225–264.

issuer.[300] Research suggests that as a result of bearing this new source of uncertainty the total compensation of executives would increase.[301] The extent of any such increase would depend on the structure and conditions of the labor market for executives as well as other economic factors, including the negotiating environment and particular preferences of executives.

Notably, under a recovery policy that implements the proposed rule requirements, incentive-based compensation tied to stock price metrics such as TSR is included within the scope of compensation that may be subject to recovery. The stock price of an issuer incorporates investor expectations of cash flows and future earnings of that issuer and can be materially impacted by inaccurate reporting of financial information. In particular, inaccurate financial information could lead investors to incorrectly estimate future cash flows and potential earnings of the issuer with concurrent effects on the valuation of its stock. If the receipt of incentive-based compensation by executives is tied to stock price, then executives could receive erroneously awarded compensation and a subsequent accounting restatement due to material noncompliance with a financial reporting requirement could trigger recovery of such compensation tied to stock price.

While the economic effects associated with the inclusion of stock price and TSR within the scope of financial reporting measures would be the same as for the proposed rule and rule amendments in general, we discuss below the more specific effects stemming from this inclusion. Specifically, in the case of stock price and TSR, where the amount of erroneously awarded compensation is not subject to mathematical recalculation directly from the information in an accounting restatement, the cost of recovering incentive-based compensation may be higher. The significance of these costs would depend on the size and financial condition of the issuer, as well as the board's approach to determining the amount, if any, of excess incentive-based compensation to be recovered following a material accounting error. Since the proposed rule would require that this amount be based on a reasonable estimate of 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 been if financial statements originally had been presented as later restated) must be first determined.[302]

To reasonably estimate the ''but for'' price of the stock, there are a number of possible methods with different levels of complexity of the estimations and related costs.[303] One such method, which is often used in accounting fraud cases to determine the effects of corrective disclosure on the market price of an issuer's stock, is an ''event study.'' An event study captures the market's view of the valuation impact of an event or disclosure. In the case of a restatement, the event study estimates the drop in the stock price attributed to the announcement [304] that restated financial information is required, separate from any change in the stock price due to market factors. An event study therefore measures the net-of-market drop in the stock price,[305] which is a key input to establish the ''but for'' price at which the security is presumed to have traded in the absence of the inaccurate financial statements. In the context of an event study, to determine the net-of-market drop in the stock price, certain decisions have to be made, such as determining the appropriate proxy for the market return and statistical adjustment method (*i.e.,* a model to account for the potential difference in risk between the company and market); the model estimation period; the date and time that investors learned about the restatement; and the length of time it took for investors to incorporate the information from the restatement into the issuer's stock price. If designed appropriately, the implementation of a robust event study method would include an evaluation of the various design choices that are anchored on objective and commonly accepted practices by the industry and relevant literature.[306] The effects of these design choices may vary from case to case. Some of the potential choices may have no effect on the results while other choices may significantly drive the results and could generate considerable latitude in calculating a reasonable estimate of the excess amount of incentive-based compensation that was erroneously awarded.

Under any reasonable methodology, calculating the ''but for'' price can be complicated when stock prices are simultaneously affected by information other than the announcement of a restatement on the event date. Confounding information potentially affecting an issuer's stock price on the event date could include other plans released by the issuer related to potential corporate actions (*e.g.,* mergers, acquisitions, or capital raising), announcements of non-restatement related performance indicators, and news related to macro-economic events (*e.g.,* news about the industry the issuer operates in, changes to the state of the

[300] Increased expected total compensation could come in the form of an increase in base salary, incentive-based compensation, or other compensation. While increasing the incentive-based component of an executive's compensation package increases the variability of the executive's compensation beyond the additional variability due to the recovery policy, the issuer may find this to be the least costly way to compensate the executive. For example, an issuer may choose to increase the incentive-based compensation component, instead of increasing base salary, because the executive's current base salary is near the limit for tax deductibility under 162(m) of the Internal Revenue Code and an increase in base salary may therefore not be tax deductible.

[301] *See* DeHaan, Hodge, and Shevlin *Does Voluntary Adoption of a Clawback Provision Improve Financial Reporting Quality?* Contemporary Accounting Research 30 (2013) 1027–1062; Babenko, Bennett, Bizjak, and Coles *Clawback Provisions* Working Paper (2012).

[302] *See* Section II.C.3.a for a discussion of the determination of the recoverable amount.

[303] The complexity of a particular methodology involves a trade-off between the potential for more precise estimates of the ''but for'' price and the assumptions and expert judgments required to implement such methodology.

[304] Event studies can have multiple event dates. For example an event study can measure the stock price impact attributed to the announcement that amended filings are required, as well as the stock price impact attributed to when the actual amended filings are made available for the investors to examine.

[305] Over the 2005–2012 period, the average stock price reaction to restatements disclosed under Item 4.02 of Form 8–K was negative 2.3 percent. *See* Scholz, S. 2013. ''Financial Restatement: Trends in the United States: 2003–2012.'' Center for Audit Quality. This study documents a substantial drop in the number and severity of restatements in the years following the enactment of SOX. The study includes 4,246 restatements reported by U.S. and foreign filers registered with the Commission from 2005 to 2012 on Form 8–K under Item 4.02. The number of restatement announcements peaked in 2006 (940), soon after implementation of SOX Section 404 internal control reporting. In subsequent years, the number of Item 4.02 restatements declined significantly, with 255 reported in 2012, a reduction of approximately 73 percent from the 2006 peak year. Restatement periods are shorter in later years, declining from an average 29 months in 2006 to 18 months in 2012.

[306] The complexity of an event study depends on the circumstances of the event and the particular approach taken. For example, one event study could use a broad market index in estimating a market model, while another event study could use a more tailored index that may take into account industry specific price movements but would require judgments on the composition of the issuers in the more tailored index. For further discussion on the complexities of event studies see Mitchell, M. and J. Netter, ''The Role of Financial Economics in Securities Fraud Cases: Applications at the Securities and Exchange Commission,'' *The Business Lawyer,* vol 49, Feb 1994, p. 565; Kothari, S.P, and J. Warner, ''Econometrics of Event Studies,'' *Handbook of Corporate Finance: Empirical Corporate Finance* (Elsevier/North-Holland), 2004; and Campbell, John Y., A. Lo, and A. C. MacKinlay, *The Econometrics of Event Studies,* NJ: Princeton University Press, 1997.

economy, and information about expected inflation). Because an issuer has influence over the timing of the release of issuer-specific information, the issuer has the ability to complicate the estimation of a reasonable ''but for'' price. For example, if an accounting restatement is expected to have a negative effect on an issuer's stock price, the executive has an incentive and often the ability to contemporaneously release positive information in an attempt to mitigate any reduction in the issuer's stock price. The strategic release of confounding information may make it more difficult for investors to evaluate the effect of the restatement on the performance of the issuer.

The proposed rule and rule amendments do not require an event study to calculate a reasonable estimate of the excess incentive-based compensation tied to stock price to be recovered after a material accounting error. Instead, the proposed rule and rule amendments would permit an issuer to use any reasonable estimate of the effect of the restatement on stock price and TSR. In addition, the proposed rule and rule amendments allow the board of directors to forego recovery if the aggregate direct costs of seeking recovery from a current or former executive officer would exceed the amount of excess incentive-based compensation to be recovered. We note that an issuer would need to incur the direct costs associated with implementing a methodology to reasonably estimate the ''but for'' price *prior to* determining whether any amount of incentive-compensation is required to be recovered under the proposed rule and rule amendments. In choosing a methodology to derive a reasonable estimate of the effect of the accounting restatement on stock price and/or TSR, issuers would likely weigh the costs of implementing any methodology against the complexity of the ''but for'' price estimate and the potential need to justify that estimate, under their unique facts and circumstances.

Some issuers may decide to use a methodology that is testable, supported by published literature, or follows procedures that derive from objective standards because such a methodology may reduce the likelihood that the reasonableness of the amount of excess incentive-based compensation required to be recovered would be challenged by interested parties, including the executives subject to recovery and the exchanges that are required to ensure that the proposed rule and rule amendments are enforced as a listing standard. The implementation of such methodology may be complex because it would likely include extensive checks of the assumptions and design choices made to generate the estimate of the ''but for'' price. If these issuers have a reasonable basis to believe that some amount of incentive-based compensation is required to be recovered, they may decide to retain an expert for the implementation of such methodology and determination of the ''but for'' price.

If an issuer chooses to retain an expert, the monetary costs that would be incurred to estimate the ''but for'' price and subsequent calculation of the amount of excess incentive-based compensation required to be recovered could be substantial. In these circumstances, we expect that the determination of the ''but for'' price would require a significant number of hours of work by highly skilled experts. In addition, once a ''but for'' price is estimated, the determination of the amount of excess incentive-based compensation could involve complex calculations and assumptions that may require additional hours of work by the expert.[307] To establish a proxy for billing rates of experts who have specialized knowledge in financial economics, we examined expert witness fees by areas of expertise. For example, based on survey responses from 21 financial experts, SEAK, Inc. 2014 Survey of Expert Witness Fees reports that the hourly fee for case review/preparation ranges from $175 to $800 with an average fee of $337 per hour.[308]

Other issuers may decide to use a methodology that results in less complex implementations to estimate the ''but for'' price [309] because, for example, by using simpler implementations, issuers may already be in a position to determine with reasonable confidence that, after taking into account a reasonable range of variation in the ''but for'' price, no amount of incentive-based compensation tied to stock price and/or TSR was erroneously awarded to executive officers in the first place and consequently no recovery is required. If an issuer chooses to implement a less complex methodology, the determination of the ''but for'' price and subsequent calculation of the amount of excess incentive-based compensation required to be recovered would entail a significantly lower number of hours of work that can be likely performed internally without retaining an expert.

Under any methodology, the variation in assumptions used to determine a reasonable estimate of the ''but for'' price (*e.g.,* determining a proxy for market returns; the date and time that investors learned about the restatement; and the length of time it took for investors to incorporate the information from the restatement into the issuer's stock price) and of the amount of excess incentive-based compensation may increase the level of perceived uncertainty that risk averse executives attach to the incentive-based component of their pay. This uncertainty may in turn make it more costly and difficult for issuers to retain executive officers' talent, when competing for that talent against unlisted companies. We note that there may be other factors affecting the ability of an issuer to attract and retain executive talent. Further, the incremental effect of the proposed rule and rule amendments is mitigated to the extent that the labor markets for executives at listed issuers and at unlisted issuers do not overlap.

The significant complications of establishing a reasonable estimate of the ''but for'' price, in conjunction with the likely monetary costs incurred to calculate it, make it difficult to assess the relative costs and benefits accruing to an issuer from enforcing a recovery policy that covers compensation based on stock price and/or TSR. These uncertainties also could undermine issuers' incentives to enforce their recovery policies and make it more difficult for exchanges to monitor compliance.[310] This effect may be partially or entirely mitigated by the requirement for issuers to provide documentation to the relevant exchange of any reasonable estimates used or attempts to recover compensation, which will assist exchanges in monitoring compliance and incentivize

[307] For example, if an executive receives at-the-money options as a form of incentive-based compensation, where the number of options is based on the current stock price, the issuer may determine that a reasonable estimate of the amount to be recovered involves recalculating both the number of options awarded as well as the value of those options that would have been issued at a different strike price.

[308] *See* SEAK, Inc. 2014 Survey of Expert Witness Fees, available at: *http://store.seak.com/2014-survey-of-expert-witness-fees/.*

[309] For example, issuers may use historical estimates of beta that are publicly available on several sources to substitute for a more complex estimation of the market model. The beta estimate of a stock captures the correlation of that stock's return with the return of the overall market over a certain period of time.

[310] Due to the discretion that an issuer may have in choosing both the method and the assumptions underlying the method to estimate a ''but for'' price, it may be difficult for an exchange to determine if the ''but for'' price resulted in a reasonable estimate of the excess incentive-based compensation required to be recovered. This may make it more difficult for exchanges to monitor compliance.

issuers to carefully document the considerations that went into the determination to enforce (or not enforce) their recovery policy. On balance, we think other aspects of the proposed rule and rule amendments, such as the ability to use reasonable estimates and the board's discretion not to pursue recovery when the direct enforcement costs would exceed the amount to be recovered, may serve to mitigate these costs; however, below we request comment on this aspect of the proposed rule and rule amendments to help us better understand its economic effects.

Notably, incentive-based compensation as defined in the proposed rule and rule amendments would not include base salary; compensation tied to operational metrics that are not financial reporting measures; or compensation awarded solely at the issuer's discretion. These forms of compensation would not be subject to recovery under a policy that meets the proposed rule requirements. These exclusions may create the incentive to shift compensation from forms that are subject to recovery to forms that are not subject to such recovery. This would apply to both re-negotiated compensation packages as well as newly instituted ones. The incentive to shift compensation away from forms that are subject to a recovery policy may affect the level of incentive alignment between executive interests and shareholder interests in terms of the enhancement of firm value, which depends on how well performance metrics used as triggers in compensation contracts capture the relationship between an executive's effort to enhance firm value and the actual enhancement of firm value.

The incentive to substitute away from incentive-based compensation tied to financial reporting measures may result in base salary or performance-based compensation tied to operational metrics being a larger portion of the executive officer's compensation package. This could reduce pay-for-performance sensitivity and may reduce the correlation between the executive officer's effort to enhance value and executive compensation if these alternative metrics are poor substitutes for financial reporting measures. In addition, as a result of the proposed rule and rule amendments, an issuer's board of directors may use increased discretion in setting compensation awards, since compensation that is solely awarded at the discretion of the board, such as bonuses, would not be subject to recovery under the proposed rule and rule amendments. Issuers may adjust compensation policies to be more dependent on the discretion of the board, which may make it more difficult for investors to understand the incentives of executives and may result in lower pay-for-performance sensitivity.[311]

The implementation of a mandatory recovery policy may also make it less costly overall to use incentive-based compensation. Without a recovery policy, as noted above, a compensation package with significant incentive-based compensation components based on financial reporting measures may provide incentives for an executive to engage in conduct that could result in inaccurate financial reporting. If a recovery policy encourages business practices and accounting judgments that are less likely to result in a material accounting error, the benefits to the issuer of having higher quality financial reporting could more than offset the additional compensation executives require to bear the increased uncertainty about the compensation they expect to ultimately retain.[312]

The proposed rule and rule amendments may have effects on the competition among issuers for executive officers. By increasing uncertainty and reducing the perceived value of the expected incentive-based compensation of an executive, companies where the proposed rule and rule amendments apply (*i.e.,* listed issuers) may have more difficulty attracting talented executives and, as such, may be at a comparative disadvantage to companies that are not covered (*i.e.,* unlisted issuers and private companies). It is unclear to what extent the labor market for executives at listed issuers and the labor market for executives at unlisted issuers and private companies overlap. The more these labor markets are segmented, the lower the comparative disadvantage potentially imposed by the proposed rule requirements.

3. Additional Potential Effects on Listed Issuers

We anticipate several effects of the proposed rule and rule amendments on listed issuers. Although we believe some issuers have already implemented recovery policies broadly consistent with the proposed rule requirements, the most immediate outcome of the proposed rule and rule amendments would be the establishment of listing standards that would result in issuers implementing recovery policies consistent with Section 10D. Under such recovery policies, an immediate benefit for a listed issuer would be the recovery of incentive-based compensation that was erroneously paid to executive officers, which would then be available for the issuer to invest in productive assets that may generate value for shareholders. Although recovery of erroneously paid compensation would provide an immediate benefit for issuers and shareholders, we note that, in many cases, these funds are not likely to be significant in the context of the issuer's business operations, and thus this effect may not be as consequential as the other, more indirect effects that we discussed above on financial reporting quality and executive compensation packages.[313]

We also anticipate direct benefits to flow from the disclosure of the recovery policy that are separate from any pecuniary recovery following an accounting restatement. Currently, an issuer could have a compensation recovery policy but choose not to disclose the existence or the terms of that policy. Under the proposed rule and rule amendments, the issuer's recovery policy would be required to be filed as an exhibit to the issuer's annual report on Form 10–K, 20–F or 40–F or, for registered management investment companies, on Form N–CSR. The proposed rule and rule amendments also require the disclosure be provided in interactive data format using XBRL. This may facilitate the extraction and analysis of the information contained in the disclosure across a large number of issuers or, eventually, over several years. This requirement would impose additional costs and burdens on issuers,

[311] If the issuer transitions to compensation that is not payable on account of the attainment of one or more performance goals, such as compensation payable solely at the discretion of the board of directors, the issuer may lose the ability to deduct a portion of executive compensation under Section 162(m) of the Internal Revenue Code. This may mitigate the incentive for companies to transition compensation away from performance-based metrics.

[312] A voluntarily implemented recovery policy may not reduce the expected cost of issuing incentive-based compensation because of insufficient incentive for board members to enforce the recovery after a material restatement. The proposed rule, which conditions initial and continued listing of securities on compliance with the recovery policy, substantially increases the incentives of board members to enforce the policy.

[313] Based on an analysis of executive compensation using Standard & Poor's Compustat and Executive Compensation databases, in fiscal year 2013 non-salary compensation for all named executive officers combined was 0.4 percent of net income. This represents an upper bound for the amount of incentive-based compensation for named executive officers. This number does not include current and former executive officers that would be covered by the proposed rule but are not named executive officers.

but despite these costs, some shareholders and prospective investors may benefit from the data tagging requirement to the extent that it is helpful in extracting the tagged information across large number of filings.

With this information investors would have a better understanding of the incentives of the issuer's executive officers, owing to more complete disclosure of the issuer's compensation policies, including its recovery policy. Moreover, while all listed issuers would be required to adopt and comply with a recovery policy satisfying the requirements of the proposed rule and rule amendments, issuers would have the choice to implement recovery policies that are more extensive than these requirements. For example, issuers may choose to establish more stringent recovery policies (*e.g.,* a longer look-pack period, more forms of compensation subject to recovery, or more individuals covered) to provide a positive signal to the market regarding their approach to executive compensation. If variation in the scope of issuers' recovery policies emerges across issuers, disclosure of those policies may improve allocative efficiency by allowing investors to make more informed investment decisions based on a better understanding of the incentives of the executives. The requirement to publish recovery policies may make such variation more likely to emerge.[314]

Further, if at any time during the last completed fiscal year a listed issuer's recovery policy required that issuer to recover excess incentive-based compensation, the proposed rule and rule amendments would require the issuer to disclose details of the recovery efforts under proposed Item 402(w) of Regulation S–K. These disclosures would allow existing and prospective shareholders to observe whether issuers are enforcing their recovery policies consistent with Section 10D. This would also help exchanges monitor compliance. Similarly, the requirement to disclose instances in which the board does not pursue recovery and its reasons for doing so (*i.e.,* because the expense of enforcing recovery rights would exceed the recoverable amount or because the recovery would violate a home country's laws), would permit shareholders to be aware of the board's actions in this regard and thus potentially hold board members accountable for their decisions.

There are a number of direct costs for issuers resulting from the proposed rule and rule amendments. As part of the implementation of a recovery policy that meets the proposed rule requirements, issuers would likely incur legal and consulting fees to develop policies that comply with the proposed requirements and to modify the compensation packages of executive officers to conform to those policies. Moreover, even those issuers that already have recovery policies would likely incur some costs to revise those policies to comply with the proposed rule requirements. We note, however, that those issuers that currently have recovery policies similar to the proposed rule requirements likely would not incur significant additional costs. While we do not have the data to quantify the implementation costs, we expect that these costs will vary with the complexity of the compensation practices of the issuer as well as the number of executive officers the recovery policy will apply to. In addition to these implementation costs, issuers also would incur direct costs to provide the required disclosures about their compensation recovery policies, including costs to tag the required disclosure in XBRL format, as described above. For purposes of our Paperwork Reduction Act (PRA) Analysis, we estimate that the proposed disclosure requirement would impose a minimal internal burden of approximately one hour. If an issuer is required to recover erroneously awarded compensation, the issuer would incur a direct cost to prepare and disclose the information required by proposed Item 402(w) (and for registered management investment companies, new Item 12 to Form N–CSR and Item 22(b)(20) of Schedule 14A) and the corresponding narrative. For purposes of our PRA, we estimate that proposed disclosure requirement would impose a burden of approximately 21 hours.[315]

There would also be costs attendant upon any recovery actions taken under the new mandated recovery policy. The proposed rule and rule amendments would require a recovery policy to recover excess compensation that was paid based on the achievement of a financial reporting measure that was later restated. The issuer would likely face costs to calculate the amount to be recovered. This could be done internally or the issuer could choose to retain an accountant or other expert to calculate this amount. The costs of calculating the amount to be recovered likely will vary depending on the nature of the restatement, the type of compensation involved and the periods affected. Given this variation, it is difficult to derive a precise estimate of these costs; however, we believe that if outside professionals are retained to assist with the calculations, they will likely charge between $200 and $400 per hour for their services.[316] Whatever the precise costs, we note they are likely to be significantly less than the costs associated with performing the restatement itself.

Depending on the circumstances, there may be other costs associated with enforcing the mandatory recovery policy. For example, the issuer may incur costs to trace specific shares to determine if the executive sold shares that were awarded based on an erroneous financial reporting measure. If the current or former executive officer is unwilling to return excess incentive-based compensation, the issuer may incur legal expenses to pursue recovery through litigation or arbitration. If the aggregate direct costs incurred to seek recovery from an executive or former executive officer would exceed the erroneously paid incentive-based compensation, the proposed rule and rule amendments would allow discretion on the part of the board of directors in determining whether to pursue recovery. This discretion may mitigate the direct costs of enforcement to issuers. Finally, if an issuer does not take action when required under its recovery policy, then the issuer may also incur costs associated with the listing exchange's proceedings to delist its securities.

These effects of the proposed rule and rule amendments may vary across different types of listed issuers. In particular, the effects of implementing a recovery policy could be greater (or lower) on SRCs, relative to non-SRCs, to the extent that SRCs use a higher (or lower) proportion of incentive-based compensation than other issuers.

[314] In the absence of a mandatory requirement for issuers to implement and disclose a recovery policy, investors may be uncertain about whether the implementation of a voluntary recovery policy by an issuer is a credible signal of the issuer's approach to executive compensation. By increasing the likelihood of a recovery policy being enforced, the proposed rules and rule amendments may make the signal more credible and allow issuers to differentiate themselves based on variation in the scope of a recovery policy.

[315] *See* Section IV.C, below, for a more extensive discussion of these disclosure burdens, including the monetization and aggregation across issuers of these direct costs.

[316] Staff estimate is based on wage information compiled by the U.S. Bureau of Labor Statistics, Occupational Employment Statistics for the Financial Analyst occupation. As of May 2014, the median hourly wage for a financial analyst was $37.80 and the 90th percentile hourly wage was $74.36. The hourly wage is multiplied by a factor of 5.35 to account for bonuses, employee benefits, and overhead.

Analysis by Commission staff finds evidence that SRCs, on average, use a lower proportion of performance-based compensation than non-SRCs, suggesting a lower potential impact of the proposed rule and rule amendments on SRCs.[317] However, there is also evidence that companies that are typically required to restate financial disclosures are generally smaller than those that are not required to restate financial disclosures, suggesting that there could be a greater incidence of recoveries at SRCs.[318] One academic study suggests that the likelihood of reporting a material weakness in internal controls over financial reporting decreases as the size of the issuer increases.[319] This may imply that, relative to non-SRCs, the proposed rule and rule amendments may cause executives at SRCs to devote proportionately more resources to the production of high-quality financial reporting. Finally, to the extent that implementation of the proposed rule and rule amendments entails fixed costs, SRCs, because of their smaller size, would incur a greater proportional compliance burden than larger issuers.

The proposed rule and rule amendments also may affect EGCs differently than non-EGCs. Relative to non-EGCs, EGCs can be characterized as having higher expected growth in the future and potentially higher risk investment opportunities.[320] As such, relative to non-EGCs, the market valuations of EGCs may be driven more by future prospects than by the value of current assets. As discussed previously, a recovery policy could reduce the incentive of an executive officer to invest in certain value-enhancing projects that may increase the likelihood of a material accounting error. The reduced incentive of executive officers could have a greater adverse effect for EGCs, relative to non-EGCs, to the extent that executives at EGCs are more likely to forgo value-enhancing growth opportunities as a result of the proposed rule and rule amendments, which as discussed above, may have a larger impact on the market value of equity of EGCs, relative to non-EGCs. However, EGCs also tend to be smaller than non-EGCs,[321] which may imply that EGCs have a higher likelihood of an accounting restatement and a higher likelihood of reporting a material weakness in internal controls over financial reporting. Similar to SRCs, this may imply that, relative to non-EGCs, the proposed rule and rule amendments may cause executives at EGCs to devote proportionately more resources to the production of high-quality financial reporting.

4. Potential Effects on U.S. Exchanges

Proposed Rule 10D–1 would affect U.S. exchanges by requiring them to adopt listing standards that prohibit the initial or continued listing of an issuer that does not comply with the proposed rule and rule amendments. The requirement places a direct burden on exchanges to amend applicable listing standards. This burden could involve deploying legal and regulatory personnel to develop listing standards that comply with the proposed rule requirements. Moreover, the exchanges are likely to incur some costs associated with tracking the compliance of each issuer. We anticipate these costs to be minimal as exchanges likely already have robust compliance tracking systems and personnel that are dedicated to ensuring listing standards are met. Finally, if an issuer chooses not to implement a recovery policy or does not take action when required under its recovery policy, the exchanges would incur costs to enforce the listing standards required by the proposed rule and rule amendments. This would also result in a loss of the revenue associated with the delisted issuer.

In the event that issuers alter their decisions regarding where to list due to the proposed rule and rule amendments, revenue of U.S. exchanges may be affected. For example, there could be revenue effects for U.S. exchanges if issuers choose to list their securities on a foreign exchange without such a compensation recovery policy requirement. More generally, if the mandated listing requirements are perceived to be particularly burdensome for listed issuers, this could adversely impact the competitive position of U.S. exchanges vis-à-vis those foreign exchanges that do not enforce similar listing standards. However, given the costs associated with transferring a listing and the broad applicability of the proposed rule to securities listed on U.S. exchanges, we do not believe it is likely that the proposed rule requirements would compel a typical issuer in the short-term to find a new trading venue not subject to these requirements. The proposed rule and rule amendments may result in a loss of potential revenue to exchanges to the extent that issuers, who would have decided to list on an exchange in the absence of the proposed rule requirements, choose to forgo listing or delay listing until the issuers' circumstances change.[322] The magnitude of this effect on exchanges is not quantifiable given the absence of data. It could be significant because the loss in potential revenue from the total number of issuers that have chosen to forgo or delay listing aggregates over

[317] Commission staff analyzed the composition of total compensation paid to all named executive officers whose compensation was reported in the Summary Compensation Table for 50 randomly selected SRCs and 50 randomly selected non-SRCs in fiscal year 2013. Staff found that, on average, SRCs pay 60 percent of total compensation in base salary versus 36 percent for non-SRCs; SRCs pay 13 percent of total compensation in stock awards versus 27 percent for non-SRCs; and SRCs pay 5 percent of total compensation in non-equity incentive plan compensation versus 16 percent for non-SRCs. Since the Summary Compensation Table does not provide sufficient information to determine if stock awards or non-equity incentive plan compensation would constitute ''incentive-based compensation'' as defined in the proposed rule, these differences should be taken as maximum estimated differences of incentive-based compensation for named executives. Staff did not find significant differences between SRCs and non-SRCs in the percent of compensation paid as a bonus, in option awards, in nonqualified deferred compensation, or in other compensation. We also note that the proposed rule covers a broader set of employees than the named executives required to report within the Summary Compensation Table.

[318] *See* Scholz, S. 2013. ''Financial Restatement: Trends in the United States: 2003–2012.'' Center for Audit Quality.

[319] *See* Doyle, Ge, and McVay *Determinants of weaknesses in internal control over financial reporting* Journal of Accounting and Economics 44 (2007) 193–223.

[320] In an analysis of 270 EGCs with fiscal year 2013 data available in the Standard & Poor's Compustat and the CRSP monthly stock returns databases, Commission staff found that on average EGCs have higher research and development expenses as a percent of total assets. Further, on average EGCs have a lower book-to-market ratio, which is indicative of shareholders expecting higher than average growth in the future. For this analysis staff set book-to-market to the 0.025 and 0.975 percentile for values outside of that range; staff set research and development to the 0.975 percentile for values about that level; and staff restricted the analysis to companies that issued common equity and were listed on NYSE, NYSE MKT, or NASDAQ.

[321] Using the same dataset referenced in note 322 above, staff found that the average market capitalization of EGCs is approximately $1.08 billion while the average market capitalization of non-EGCs is approximately $6.09 billion. Staff also found that the smallest EGCs tend to be similar in market capitalization to the smallest non-EGCs, with the 10th percentile of the distributions of the market capitalization of EGCs and non-EGCs being approximately $48 million and $45 million, respectively. Conversely, staff found that the largest EGCs tend to have substantially lower market capitalizations than the largest non-EGCs, with the 90th percentile of the distributions of the market capitalization of EGCs and non-EGCs being approximately $2.49 billion and $11.59 billion.

[322] We note that capital formation could be hindered if an issuer chooses to forgo or delay listing because of the proposed rule and rule amendments and the alternative methods of raising capital result in less liquid securities being issued or less thorough disclosures being required. We also note that other factors may affect the decision for an issuer to list and any effect from the proposed rule and rule amendments would be incremental to these other factors.

time, thus having lasting impact on the exchanges' revenue.

While we believe the typical issuer is unlikely to transfer listing in the short-term as a result of the proposed rule and rule amendments, the potential response of foreign issuers is less clear. On one hand, by virtue of listing on a U.S. exchange, a foreign issuer has demonstrated willingness to list outside of the issuer's home country. The issuer presumably chose to list on a U.S. exchange because the particular U.S. exchange is an advantageous trading venue for the issuer's securities. Although the direct costs are not expected to be substantial, the proposed rule and rule amendments would increase the compliance burden on listed issuers and could thereby potentially reduce the advantage of listing on a U.S. market. As a result, foreign issuers could choose to delist from U.S. exchanges. Further, foreign issuers that are not currently listed on U.S. exchanges, but are considering listing on a non-home country exchange, may choose to list on a foreign exchange because of the increased burden of our proposed rule and rule amendments. At the same time, we understand that many foreign issuers list on a U.S. exchange to signal their high quality, which is achieved by subjecting themselves to more rigorous corporate governance rules and regulations. As a result, many foreign issuers may gain the ability to raise capital at a reduced cost compared to their home market by listing on U.S. exchanges. Hence, some foreign issuers seeking access to U.S. capital markets may view the requirements as beneficial. Therefore, the revenue effect on U.S. exchanges resulting from the behavior of foreign issuers is unclear, because while some foreign issuers may choose to delist as a result of the proposed rule and rule amendments, others may choose to list because of them.

Finally, the proposed rule and rule amendments apply to all issuers who list securities on a national securities exchange. As such there are unlikely to be competitive effects between national securities exchanges due to all national securities exchanges being affected by the proposed rule requirements.

5. Indemnification and Insurance

The benefits discussed above would result from an executive's changes in behavior as a result of incentive-based compensation being at risk for recovery should a material accounting error occur. These benefits would be substantially undermined if the issuer were able to indemnify the executive for the loss of compensation. Moreover, shareholders would bear the cost of providing such indemnification. Therefore, the proposed rule and rule amendments expressly prohibit listed issuers from indemnifying executives against the loss of erroneously awarded compensation or paying or reimbursing executives for insurance premiums to cover losses incurred under the recovery policy.

Although reimbursement of insurance premiums by issuers would be prohibited, the insurance market may develop a policy that would allow an executive, as an individual, to purchase insurance against the loss of incentive-based compensation when the material accounting error is not attributable to the executive. In that event, an executive would be able to hedge the risk that results from a recovery policy. If an executive purchased this type of insurance policy, the benefits of the issuer's recovery policy could be reduced to the extent that insurance reduces the executive's incentive to ensure accurate financial reporting. However, to the extent an insurance policy does not cover losses resulting from the recovery of compensation attributed to a material accounting error that resulted from inappropriate actions by the insured executive, then incentives would remain for the executive to ensure accurate financial reporting.

The development of this type of private insurance policy for executives would also have implications for issuers. Overall, it could make it less costly for an issuer to compensate an executive after implementing a recovery policy. Without insurance, an issuer that implemented a recovery policy would likely have to adjust compensation to account for the loss in expected incentive-based compensation in addition to the increased uncertainty in incentive-based compensation. If an active insurance market develops such that the executive could hedge against the uncertainty caused by the recovery policy, then market-determined compensation packages would likely increase to cover the cost of such policy. While the proposed rule and rule amendments explicitly prohibit issuers from reimbursing an executive for the cost of such insurance policy, a market-determined compensation package would likely account for the hedging cost and incorporate it into the base salary of the executive's compensation. This increase would likely be less than the increase in the market-determined compensation packages if an insurance policy was unavailable because a risk averse executive would no longer need to bear recovery policy induced uncertainty.

C. Alternatives

Below we discuss possible alternatives to the proposed rule and rule amendments we considered and their likely economic effects.

1. Exemptions for Certain Categories of Issuers

We considered exempting (or permitting the exchanges to exempt) SRCs and EGCs from proposed Rule 10D–1. As discussed above, the proposed rule and rule amendments may impose certain disproportionate costs on SRCs and EGCs. However, SRCs and EGCs may have an increased likelihood of reporting a material accounting error and may be more likely to report a material weakness in internal controls over financial reporting, due to their smaller size relative to non-SRCs and non-EGCs. As such, we believe the benefits of the proposed rule and rule amendments may be particularly salient for these categories of issuers. For these reasons, SRCs or EGCs would not be exempt from the proposed rule and rule amendments.

One commenter suggested that we consider exempting FPIs, arguing that home countries would generally have a greater interest in determining whether issuers should have recourse against executives.[323] As discussed previously in the context of foreign issuers generally, the potential effect of the proposed rule and rule amendments on FPIs is difficult to predict. On the one hand, due to the potential differences in home country law, the proposed rule requirements may be especially burdensome for FPIs relative to non-FPIs.[324] On the other hand, there is evidence that many FPIs may be listing on U.S. exchanges in part in order to credibly signal to investors their willingness and ability to be subjected to stricter governance standards.[325] While FPIs may face a relatively higher burden from the proposed rule and rule amendments, they also may experience a relatively higher benefit.

2. Excluding Incentive-Based Compensation Tied to Stock Price

As discussed above, the proposed rule and rule amendments may result in

[323] *See* letter from the American Bar Association.

[324] We note that if recovery of excess incentive-based compensation would violate home country law, the proposed rule and rule amendments permit the board of directors discretion to forgo recovery as impracticable, subject to certain conditions.

[325] *See* Doidge, Karolyi, and Stulz *Why Do Foreign Firms Leave U.S. Equity Markets?* The Journal of Finance, Vol. LXV, No. 4, August 2010.

issuers incurring significant costs to recover incentive-based compensation tied to stock price. If incentive-based compensation tied to stock price were excluded from the proposed rule and rule amendments, issuers would not incur the costs associated with recovery. However, a significant component of the total performance-based compensation would be excluded from the scope of the proposed rule and rule amendments without generating the related potential benefits. In addition, the exclusion of performance-based compensation tied to stock price would provide issuers with an incentive to shift compensation away from forms subject to recovery to forms tied to market-based metrics such as stock price and TSR that would not be subject to recovery.

The economic effect of any incentive to shift away from compensation subject to recovery is difficult to predict due to the nature of incentive-based compensation tied to stock price. On one hand, incentive-based compensation tied to metrics that are market-based, such as stock price or TSR, could be highly correlated with the interests of shareholders and therefore may be beneficial to shareholders. On the other hand, because market-based measures may be influenced by factors that are unrelated to the performance of the executive officer, these metrics may not fully capture or represent the effort and actions taken by the executives. In particular, market-based measures incorporate expectations about future earnings, which may not be closely tied to the executive officer's current performance. In contrast, the use of accounting-based measures, such as those derived from revenue, earnings, and operating income, can be tailored to match a specific performance period and provide direct measures of financial outcomes.[326] To this end, accounting-based measures of performance—although not directly tied to issuer value enhancement—may better capture the effect of an executive's actions during the relevant performance period. Therefore, if incentive-based compensation tied to stock price was excluded, the incentive to substitute away from accounting-based measures to market-based measures of performance may result in compensation that is less tied to the consequences of an executive's actions during the performance period.

The optimal compensation package likely contains a mix of incentive-based compensation tied to market-based measures and accounting-based measures. Empirically, the use of market-based performance metrics is more prevalent in long-term incentive plans than in short-term incentive plans.[327] Using market-based measures of performance in short-term incentive plans may be undesirable for the executive in that the stock price may be volatile and may not reflect the executive's efforts to enhance firm value in the performance period. The relatively higher use of market-based measures in long-term incentive plans could reflect that in the long-term the executive's efforts to enhance firm value may be more likely to be incorporated in the market value of the firm. Short-term and long-term performance-based compensation may act as complements, with the different performance measures used to award each type reflecting the compensation committee's effort to align the executive's interests with those of the shareholders. The exclusion of incentive-based compensation tied to stock price may affect the relative mix of short-term and long-term performance-based compensation, or the performance measures that each type is linked to, and as such a recovery policy may have large economic effects through a change in the incentives of the executive.

3. Other Alternatives Considered

One commenter suggested that the Commission specifically authorize the use of a nonqualified deferred compensation plan (*e.g.,* a ''holdback plan'' or ''bonus bank'') to aid in the recovery of erroneously awarded incentive-based compensation.[328] A bonus bank would likely reduce the enforcement costs of recovering erroneously awarded incentive-based compensation. On the other hand, a bonus bank may further augment any increase in compensation necessary to offset the expected cost to the executive of a recovery policy. This is due to the executive not having access to the funds she has earned and having to delay consumption that would otherwise be possible. Further, as the commenter acknowledged, a bonus bank implicitly makes the executive a creditor to the issuer, resulting in reduced risk-taking incentives for the executive. While for some companies reduced risk-taking incentives may be value increasing, for other companies reduced risk-taking incentives may be value decreasing. Further, by making the executive a creditor to the issuer, a bonus bank reduces the incentive alignment between equity holders and the executive officer.

One commenter suggested that the Commission also require issuers to recover a proportionate amount of the compensation tied to qualitative variables or board judgment after a material accounting error.[329] Relative to the proposed rule and rule amendments, this alternative implementation would reduce the incentive to alter the composition of an executive's compensation package to more heavily weight qualitative variables or board judgment, while increasing the incentive to more heavily weight base salary as well as performance-based compensation tied to metrics other than financial reporting measures. To the extent that performance compensation based on qualitative variables and board judgment allows the board to compensate the executive officer for performance that is otherwise difficult to measure, the reduced weight on this form of performance-based compensation could make it more difficult for the board to align the executive officer's interests with those of the shareholders. On the other hand, reduced weight on this form of performance-based compensation could make it easier for shareholders to understand the incentives of the executive officer. Because a greater amount of performance-based compensation would be at risk for recovery, implementing this alternative implementation could also increase the amount of expected compensation the executive officer would require in order to voluntarily bear the increased uncertainty.

D. Request for Comment

We request data to quantify the costs and benefits described throughout this release. We seek estimates of these costs and benefits, as well as any costs and benefits not already identified, that may result from the adoption of the proposed rule and rule amendments. We also request qualitative feedback on the nature of the economic effects, including the benefits and costs, we have identified and any benefits and costs we may have overlooked.

To assist in our consideration of the economic effects of the proposed rule and rule amendments, we request comment on the following:

[326] Six of the eight most frequently used metrics to award compensation in short-term incentive plans were accounting-based measures. Those measures are earnings, revenue, operating income, EBITDA, cash flow, and return on capital. *See* Equilar *Measuring Short-Term and Long-Term Performance in 2012.*

[327] *See* Equilar *Measuring Short-Term and Long-Term Performance in 2012.*

[328] *See* letter from Clark Consulting.

[329] *See* letter from AFL–CIO.

1. We request comment on all aspects of the economic effects, including the costs and benefits of the proposed rule and rule amendments, and identification and assessment of any effects not discussed herein. In addition, we seek estimates and views regarding these costs and benefits for particular types of issuers, including SRCs, EGCs, FPIs, registered management investment companies, and issuers that only have listed debt or preferred equity securities, as well as the costs or benefits for any other types of issuers that may result from the adoption of these proposed amendments.

2. What, if any, effects on financial reporting or executive compensation practices might arise from the requirement for listed issuers to recover erroneously awarded incentive-based compensation as proposed?

3. Would proposed Rule 10D–1 lead to higher quality financial reporting? If so, explain how this would occur, and how the rule might be revised to mitigate any adverse unintended consequences?

4. Would proposed Rule 10D–1 incentivize listed issuers to conclude that a material error is not material in order to avoid recovery of incentive-based compensation? Would the proposed rule and rule amendments incentivize listed issuers to delay investigating or reporting a material error?

5. What is the likely effect of the requirement on executive compensation practices of listed companies, and how would this effect likely vary according to the issuer's size or line of business?

6. What is the likely burden that listed issuers would incur to modify the compensation packages of executive officers?

7. What would be the burden if issuers were required to recover only the amount of excess incentive-based compensation tied to accounting-based performance metrics? Would the burden be different in the case of recovery of excess incentive-based compensation tied to market-based performance metrics? What are the benefits of each approach?

8. What implementation issues, if any, would issuers encounter in conducting an event study or otherwise establishing the ''but-for'' price?

9. What is the cost of establishing a ''but for'' price and determining the amount of excess incentive-based compensation to be recovered? What factors affect the determination of reasonable estimates of the ''but for'' price and of this amount? Would issuers seek expert help in making such determinations? If so, what would be the costs to issuers of retaining such experts?

10. Would it be more difficult for exchanges to monitor compliance with the proposed rule and rule amendments for compensation tied to market-based performance metrics? Is the documentation required to support the analyses of the issuer sufficient for compliance monitoring? If not, what other documentation should be required?

11. Would there be any significant transition costs imposed on listed issuers as a result of the proposals, if adopted? Please be detailed and provide quantitative data or support, as practicable.

12. How is this rulemaking likely to affect the market for executive officers?

13. What is the likely effect of this rulemaking on the decision to be a listed issuer in the United States, and how does this effect vary according to the size or line of business of the issuer?

14. Are there additional alternatives to the proposals we should consider that would satisfy the requirements of new Section 10D of the Exchange Act? If so, please describe.

IV. Paperwork Reduction Act

A. Background

Certain provisions of the proposed rule and rule amendments contain a ''collection of information'' within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[330] The Commission is submitting the proposed rule and rule amendments to the Office of Management and Budget (''OMB'') for review in accordance with the PRA.[331] An agency may not conduct or sponsor, and a person is not required to comply with, a collection of information unless it displays a currently valid OMB control number. The titles for the collections of information are:[332]

''Regulation S–K'' (OMB Control No. 3235–0070);

''Regulation 14A and Schedule 14A'' (OMB Control No. 3235–0059);

''Regulation 14C and Schedule 14C'' (OMB Control No. 3235–0065);

''Form 10–K'' (OMB Control No. 3235–0063);

''Form 20–F'' (OMB Control No. 3235–0288);

''Form 40–F'' (OMB Control No. 3235–0381);

''Rule 20a–1 under the Investment Company Act of 1940, Solicitations of Proxies, Consents, and Authorizations'' (OMB Control No. 3235–0158); and

''Form N–CSR'' under the Securities Exchange Act of 1934 and under the Investment Company Act of 1940, Certified Shareholder Report of Registered Management Investment Companies'' (OMB Control No. 3235–0570).

Regulation S–K was adopted under the Securities Act and the Exchange Act. Regulations 14A and 14C and the related schedules, Form 10–K, Form 20–F and Form 40–F were adopted under the Exchange Act. Rule 20a–1 was adopted under the Investment Company Act, and Form N–CSR was adopted under the Exchange Act and Investment Company Act. The regulations, schedules and forms set forth the disclosure requirements for proxy and information statements and annual reports filed by issuers to help shareholders make informed voting and investment decisions. Our proposed rule and rule amendments to existing regulations, schedules and forms are intended to implement new Section 10D of the Exchange Act.

The hours and costs associated with preparing and filing the forms and preparing, filing and sending the schedules constitute reporting and cost burdens imposed by each collection of information. Compliance with the amendments is mandatory. Responses to the information collections will not be kept confidential and there is no mandatory retention period for the information disclosed.

B. Summary of Proposed Rule and Rule Amendments

We are proposing new Rule 10D–1 under the Exchange Act and amendments to Items 601, 402 and 404 of Regulation S–K, Schedule 14A, Form 20–F, Form 40–F, and Form N–CSR to implement the provisions of Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which added Section 10D to the Securities Exchange Act of 1934. Section 10D requires the Commission to adopt rules directing the exchanges and associations to prohibit the listing of any security of an issuer that is not in compliance with Section 10D's requirements concerning disclosure of the issuer's policy on incentive-based compensation and recovery of erroneously awarded compensation. In accordance with the statute, proposed Rule 10D–1 directs the exchanges to establish listing standards that, among other things, require each issuer to adopt and comply with a policy

[330] 44 U.S.C. 3501 *et seq.*

[331] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

[332] The paperwork burden from Regulation S–K is imposed through the forms that are subject to the requirements in those regulations and is reflected in the analysis of those forms. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens and for administrative convenience, we assign a one-hour burden to Regulation S–K.

providing for recovery, under certain circumstances, of incentive-based compensation received by current or former executive officers and to file all disclosure with respect to that policy in accordance with Commission rules.

To implement Section 10D(b)(1), we are proposing to add new disclosure provisions to Items 601 and 402 of Regulation S–K, Schedule 14A, Form 20–F, Form 40–F, and Form N–CSR. The new disclosure provisions would require each listed issuer to file the issuer's policy, if applicable, regarding recovery of incentive-based compensation from its executive officers as an exhibit to its Exchange Act annual report or, in the case of a listed registered management investment company, its Form N–CSR annual report. A new instruction to the Summary Compensation Table would require that any amounts recovered pursuant to the listed issuer's policy reduce the amount reported in the applicable column and total column for the fiscal year in which the amount recovered initially was reported.

In addition, if during the last completed fiscal year, either a restatement was completed that required recovery of excess incentive-based compensation pursuant to a listed issuer's recovery policy, or there was an outstanding balance of excess incentive-based compensation from the application of the policy to a prior restatement, proposed Item 402(w) would require the listed issuer to disclose: [333]

- For each restatement,
  - The date on which the listed issuer was required to prepare an accounting restatement;
  - The aggregate dollar amount of excess incentive-based compensation attributable to the restatement;
  - The estimates used to determine the excess incentive-based compensation attributable to such accounting restatement, if the financial reporting measure related to a stock price or total shareholder return metric; and
  - The aggregate dollar amount of excess incentive-based compensation that remained outstanding as of the end of the last completed fiscal year;
- The name of each person, if any, from whom during the last completed fiscal year the listed issuer decided not to pursue recovery, the amount forgone from each such person, and a brief description of the listed issuer's reasons for not pursuing recovery; and
- The name of, and amount due from, each person from whom, at the end of its last completed fiscal year, excess incentive-based compensation had been outstanding for 180 days or longer since the date the issuer determined the amount the person owed.

We propose that the same disclosure requirements apply to listed U.S. issuers and listed foreign private issuers, including MJDS filers. These disclosure requirements would increase the amount of information that listed U.S. issuers and listed foreign private issuers must compile and disclose in their schedules and forms. For listed U.S. issuers, other than registered management investment companies, the proposed amendments to Items 402 and 601 of Regulation S–K would require additional disclosure in Exchange Act annual reports and proxy or information statements filed on Schedule 14A or Schedule 14C relating to an annual meeting of shareholders, or a special meeting in lieu of an annual meeting, at which directors are to be elected and would increase the burden hour and cost estimates for each of those forms. For a listed management investment company registered under the Investment Company Act of 1940, the proposed amendments to Form N–CSR and Schedule 14A would require additional disclosure and would increase the burden hour and cost estimates associated with Form N–CSR and Rule 20a–1, if the registered investment company pays incentive-based compensation. For a listed foreign private issuer filing an annual report on Form 20–F, Form 40–F or, if a foreign private issuer elects to use U.S. registration and reporting forms, on Form 10–K, the proposed amendments to those forms and the proposed amendment to Item 402(a)(1), respectively, would require additional disclosure in annual reports and would increase the burden hour and costs estimates for each of these forms. The disclosure required by proposed Item 402(w), proposed paragraph 22(b)(20) to Schedule 14A, proposed new Item 12 to Form N–CSR, and proposed Item 6.F of Form 20–F would be required to be block-text tagged in XBRL.

C. Paperwork Reduction Act Burden Estimates

As proposed, the information a listed U.S. issuer is required to compile and disclose regarding its policy on incentive-based compensation pursuant to Item 402(w) would supplement information that U.S. issuers that are not registered management investment companies, smaller reporting companies or emerging growth companies are already required to provide elsewhere in their executive compensation disclosure, if material. Specifically, these issuers are required to provide information relating to the compensation of the named executive officers, including policies and decisions regarding the adjustment or recovery of awards or payments if the relevant performance measures upon which they are based are restated or otherwise adjusted in a manner that would reduce the size of an award or payment.[334] With respect to registered management investment companies subject to proposed Rule 10D–1, information mirroring the proposed Item 402(w) disclosure would be included in annual reports on Form N–CSR and in proxy statements and information statements relating to the election of directors.[335] Such information would also supplement existing disclosures.

Similarly, for a listed foreign private issuer filing an annual report on Form 20–F or, if a foreign private issuer elects to use U.S. registration and reporting forms, on Form 10–K, the proposed amendments would supplement existing disclosures. Currently, Item 7.B of Form 20–F requires disclosure of transactions between the issuer and senior management of the nature and extent of any transactions that are material to the company or related party that are unusual in their nature or conditions involving services to which the company was a party. Although this disclosure requirement generally would require disclosure of the recovery of excess incentive-based compensation, it may not elicit the same information required to be provided under the proposed rule and rule amendments.

We arrived at the estimates discussed below by reviewing our burden estimates for similar disclosure and

[333] *See* proposed Item 402(w) of Regulation S–K, proposed Item 6.F of Form 20–F, and proposed Paragraph (17) of Paragraph B of Form 40–F. We also are proposing to amend the instructions to Items 404(a) of Regulation S–K so that a listed issuer that complies with Item 402(w) disclosure requirements would not need to disclose any incentive-based compensation recovery pursuant to those requirements. We are also proposing to amend Form N–CSR and Item 22 of Schedule 14A to require registered management investment companies that would be subject to Rule 10D–1 to provide information that would mirror the disclosure requirements of proposed Item 402(w).

[334] *See* Item 402(b)(2)(viii) of Regulation S–K.

[335] Proposed Item 12 of Form N–CSR; proposed Item 22(b)(20) of Schedule 14A. We are also proposing to amend General Instruction D to Form N–CSR to permit registered management investment companies subject to proposed Rule 10D–1 to answer the information required by proposed Item 12 by incorporating by reference from the company's definitive proxy statement or definitive information statement.

considering our experience with other tagged data initiatives. We believe that the preparation of the information required by proposed Item 402(w) and the corresponding narrative disclosure provisions is comparable to an issuer's preparation of the disclosure required by the amendments to enhance certain aspects of proxy disclosure.[336] The amendments in that release were largely designed to enhance existing disclosure requirements. Similarly, we believe that the proposed Item 402(w) amendments would enhance the disclosure that is already required by Item 402 of Regulation S–K and disclosure that is required by Section 10D(b)(1). We believe that certain of the information required to prepare the new disclosure would be readily available to some U.S. issuers because this information, if material, is required to be gathered, determined or prepared in order to satisfy the other disclosure requirements of Item 402 of Regulation S–K. For other listed issuers, we believe that the information required to prepare the new disclosure requirement will not impose a significant burden because the issuer controls and possesses this information, which is a compilation of facts related to an issuer's implementation of its recovery policy if during the last completed fiscal year the issuer was required to recover excess incentive-based compensation or there was an outstanding balance of excess incentive-based compensation not recovered pursuant to that policy. In the Proxy Disclosure Enhancements release, we estimated that the amendments would impose on average an incremental burden of 25 hours for accelerated filers and 17 hours for non-accelerated filers to prepare their proxy and information statements. We believe the proposed disclosure regarding an issuer's policy on recovery of erroneously awarded compensation requires less new information than the amendments in the Proxy Disclosure Enhancements Release. We believe the primary cost elements for issuers preparing the proposed disclosure would be determining the types of incentive-based compensation awards an issuer grants to executive officers that could be subject to recovery under the issuer's recovery policy and, if necessary, gathering the information regarding the application and implementation of this recovery policy if required by a restatement.

As a result, we estimate that the average incremental burden for an issuer to prepare the new narrative disclosure would be 21 hours. This estimate includes the time and cost of preparing disclosure that has been appropriately reviewed by management, in-house counsel, outside counsel and members of the board of directors, as well as block-text tagging the data in XBRL format. Because this estimate is an average, the burden could be more or less for any particular company, and may vary depending on a variety of factors, such as the degree to which companies use the services of outside professionals or internal staff and resources to tag the data in XBRL. Issuers subject to Item 402(w) would provide the required disclosures by either including the information directly in Exchange Act annual reports or incorporating the information be reference from a proxy statement on Schedule 14A or information statement on Schedule 14C. For purposes of our PRA estimates, consistent with past amendments to Item 402,[337] we have assumed that all of the burden relating to the new narrative disclosure requirements would be associated with Form 10–K, even if registrants include the new disclosure required in Form 10–K by incorporating that disclosure by reference from the proxy statement on Schedule 14A.[338]

We believe that the requirement to file a listed issuer's recovery policy as an exhibit to its annual report pursuant to proposed Item 601(b)(96) and the corresponding provisions (and for registered investment companies, as an exhibit to its annual report on Form N–CSR pursuant to proposed Item 13(a)(2) of Form N–CSR) will be minimal. A listed issuer will be required simply to file the policy that it otherwise would be required to have pursuant to the listing standards of the exchange on which it lists securities. We estimate this burden to be approximately one hour.

As a result of the estimates discussed above, we estimate for purposes of the PRA that the total incremental burden on all listed issuers with respect to the proposed amendments would be 5,961 hours for internal company time and $203,700 for the services of outside professionals. The total incremental burden for Form 10–K would be 5,246 hours for internal company time and $138,600 for the services of outside professionals.[339] The total incremental burden for Form N–CSR would be 23 hours for internal company time and $2,100 for the services of outside professionals.[340] The total incremental burden for Form 20–F would be 553 hours for internal company time and $50,400 for the services of outside professionals and for Form 40–F would be 139 hours for internal company time and $12,600 for the services of outside professionals.[341] For Form 10–K and

[336] *See* Release No. 33–9089, *Proxy Disclosure Enhancements,* (Dec. 16, 2009) [74 FR 68334] (''Proxy Disclosure Enhancements''). The release adopted amendments to make new or revised disclosures about: Compensation policies and practices that present material risks to the company; stock and option awards of executives and directors; director and nominee qualifications and legal proceedings; board leadership structure; the board's role in risk oversight; and potential conflicts of interest of compensation consultants that advise companies and their boards of directors.

[337] We took a similar approach in connection with the rules for Summary Compensation Table disclosure required by the 2006 amendments to Item 402. *See Executive Compensation and Related Person Disclosure,* Release No. 33–8732A, n. 326 (Aug. 29, 2006) [71 FR 53158].

[338] Similarly, for purposes of the PRA estimates, we are also assuming that all of the burden relating to the new narrative disclosure requirements for registered investment companies would be associated with Form N–CSR, and therefore, we are not allocating a separate burden estimate for Rule 20a–1.

[339] This includes one hour to file the recovery policy as an exhibit to the annual report as well as the burden associated with providing Item 402(w) disclosure, when applicable. We estimate the number of responses for filing the recovery policy based on the number of listed domestic issuers filing annual reports in 2014, or 4,206 issuers. Proposed Item 402(w) would require disclosure when a listed issuer completes a restatement that requires recovery of excess incentive-based compensation pursuant to its compensation recovery policy or when there is an outstanding balance of excess incentive-based compensation from the application of the policy to a prior restatement. To estimate the burden associated with this disclosure, we looked to the number of listed issuers that filed an Item 4.02 Form 8–K (Non-Reliance on Previously Issued Financial Statements) in 2014, or 66 issuers. To calculate the total annual incremental burden arising from the new narrative disclosure, we multiplied the estimated number of annual responses (66) by 21 burden hours. We note that the number of restatements filed in any given year will vary and that, depending on the nature of their recovery efforts, certain issuers may be required to provide Item 402(w) disclosure for more than one year.

[340] We estimate seven registered management investment companies that are listed issuers and are internally managed that may have executive officers who receive incentive-based compensation. Of these seven, we assume for PRA purposes that one registered management investment company per year will be required to prepare the new narrative disclosure required by proposed new Item 12 of Form N–CSR. As indicated below, for Form N–CSR, we estimate that 75% of the burden of preparation will be carried by the registrant internally and the remaining 25% of the burden will be carried by outside professionals retained by the company at an average cost of $400 per hour. On the basis of the foregoing, we estimate an aggregate internal burden hour of 22 hours ((7 registrants × 1 hour per registrant to file the policy pursuant to proposed new Item 13(a)(2)) + (1 registrant × 21 hours per registrant to prepare the new narrative disclosure required by proposed new Item 12×75%) = 23 hours), and estimate an aggregate increase of $2,100 for the services of outside professionals (1 registrant × 21 hours per registrant to retain outside professionals to prepare the new narrative disclosure required by proposed new Item 12×25% × $400 per hour) = $2,100).

[341] Consistent with our estimates for Form 10–K, we estimate the number of responses for filing the

Form N–CSR we estimate that 75% of the burden of preparation is carried by the company internally and that 25% of the burden of preparation is carried by outside professionals retained by the company at an average cost of $400 per hour. For Forms 20–F and 40–F we estimate that 25% of the burden of preparation is carried by the company internally and that 75% of the burden of preparation is carried by outside professionals retained by the company at an average cost of $400 per hour. There is no change to the estimated burden of Regulation S–K because the burdens that this regulation imposes are reflected in our revised estimates for the forms. Similarly, there is no change to the estimated burden of Schedule 14A, Schedule 14C and Rule 20a–1 because, as noted above, the burdens associated with the proposed disclosures are allocated to Form 10–K and Form N–CSR, respectively.

We derived our new burden hour and cost estimates by estimating the total amount of time it would take a listed issuer to prepare and review the disclosure requirements contained in the final rules. This estimate represents the average burden for all listed issuers, both large and small. In deriving our estimates, we recognize that the burdens will likely vary among individual listed issuers based on a number of factors, including the size and complexity of their organizations. We believe that some listed issuers will experience costs in excess of this average in the first year of compliance with the amendments and some issuers may experience less than the average costs. A summary of the proposed changes is included in the table below.

TABLE 1—CALCULATION OF INCREMENTAL PRA BURDEN ESTIMATES [342]

	Current annual responses (A)	Proposed annual responses (B)	Current burden hours (C)	Increase in burden hours (D)	Proposed burden hours (E) = C + D	Current professional costs (F)	Increase in professional costs (G)	Proposed professional costs = F + G
Form 10–K	8137	8137	12,198,095	5,246	12,203,089	$1,627,400,000	$138,600	$1,627,538,600
Form 20–F	942	942	623,021	553	623,795	743,277,230	50.400	743,277,630
Form 40–F	205	205	22,034	139	22,425	26,440,500	12,600	26,453,100
Form N–CSR	6,576	6,576	177,799	23	177,822	3,189,771	2,100	3,191,871
Total	15,860	15,860	13,020,949	5,961	13,026,910	2,400,257,501	203,700	2,400,461,201

D. Solicitation of Comments

We request comments in order to evaluate: (1) Whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information would have practical utility; (2) the accuracy of our estimate of the burden of the proposed collection of information; (3) whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (4) whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.[343]

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing these burdens. Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090, with reference to File No. S7–12–15. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–12–15, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE., Washington, DC 20549–0213. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

V. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA),[344] we solicit data to determine whether the proposed rule and rule amendments constitute a ''major'' rule. Under SBREFA, a rule is considered ''major'' where, if adopted, it results or is likely to result in:

- An annual effect on the economy of $100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

Commenters should provide empirical data on (1) the potential annual effect on the economy; (2) any increase in costs or prices for consumers or individual industries; and (3) any potential effect on competition, investment or innovation.

VI. Initial Regulatory Flexibility Act Analysis

This Initial Regulatory Flexibility Analysis (''IRFA'') has been prepared in accordance with the Regulatory Flexibility Act.[345] This IRFA involves proposals to direct the exchanges and associations to prohibit the listing of a security of an issuer that is not in compliance with Section 10D's requirements concerning recovery of erroneously awarded compensation and to implement disclosure requirements related to the recovery of such compensation.

recovery policy based on the number of listed foreign private issuers and MJDS issuers filing annual reports in 2014, or 639 issuers. To estimate the burden associated with the disclosure required when a foreign private issuer or MJDS issuer is required to pursue recovery pursuant to its policy, we looked to the number of listed foreign private issuers and MJDS issuers that restated financial statements in 2014, or 8 foreign private issuers filing on Form 20–F and 2 MJDS issuers filing on Form 40–F. To calculate the total annual incremental burden arising from the new narrative disclosure, we multiplied the estimated number of annual responses (8 and 2, respectively) by 21 burden hours and allocated the resulting burden estimate to the relevant form.

[342] The number of responses reflected in the table equals the three-year average of the number of schedules and forms filed with the Commission and currently reported by the Commission to OMB.

[343] We request comment pursuant to 44 U.S.C. 3506(c)(2)(B).

[344] 5 U.S.C. 801 *et seq.*

[345] 5 U.S.C. 603.

A. Reasons for, and Objectives of, the Proposed Action

We are proposing a new rule and rule amendments to implement the provisions of Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which adds Section 10D to the Securities Exchange Act of 1934. Section 10D requires the Commission to adopt rules directing the exchanges and associations to prohibit the listing of any security of an issuer that is not in compliance with Section 10D's requirements concerning disclosure of the issuer's policy on incentive-based compensation and recovery of erroneously awarded compensation. In accordance with the statute, the proposed rule would direct the exchanges to establish listing standards that require each issuer to adopt and comply with a policy providing for the recovery of incentive-based compensation based on financial information required to be reported under the securities laws that is received by current or former executive officers, and to file all disclosure with respect to that policy in accordance with Commission rules.

The primary objective of the proposed rule and rule amendments is to require that all listed issuers have a policy in place to recover compensation based on material noncompliance with any financial reporting requirement. This policy would require executives to return erroneously awarded compensation without the need for shareholders to embark on costly litigation.[346] The disclosure requirements in the proposed rule and rule amendments are intended to promote consistent disclosure among issuers as to both the substance of a listed issuer's recovery policy and how the listed issuer implements that policy in practice.

B. Legal Basis

We are proposing the rule and rule amendments pursuant to Sections 6, 7, 10, and 19(a) of the Securities Act; Sections 10D, 13, 14, 23(a) and 36 of the Exchange Act and Sections 20, 30, and 38 of the Investment Company Act of 1940.

C. Small Entities Subject to the Proposed Action

The proposals would affect, among other entities, exchanges that list securities and listed issuers subject to our proxy rules. The Regulatory Flexibility Act defines ''small entity'' to mean ''small business,'' ''small organization,'' or ''small governmental jurisdiction.''[347] The Commission's rules define ''small business'' and ''small organization'' for purposes of the Regulatory Flexibility Act for each of the types of entities regulated by the Commission. Exchange Act Rule 0–10(e) provides that the term ''small business'' or ''small organization,'' when referring to an exchange, means any exchange that: (1) Has been exempted from the reporting requirements of Exchange Act Rule 601;[348] and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization, as defined under Exchange Act Rule 0–10.[349] No exchanges are small entities because none meet these criteria. Securities Act Rule 157[350] and Exchange Act Rule 0–10(a)[351] define an issuer, other than an investment company, to be a ''small business'' or ''small organization'' if it had total assets of $5 million or less on the last day of its most recent fiscal year and is engaged or proposing to engage in an offering of securities which does not exceed $5 million. The proposed rule and rule amendments would affect small entities that have a class of securities that are registered under Section 12(b) of the Exchange Act. We estimate that there are approximately 27 listed issuers, other than registered investment companies, that may be considered small entities. An investment company, including a business development company, is considered to be a ''small business'' if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[352] We believe that certain of the rule and rule amendments would affect small entities that are investment companies, including business development companies, with a class of securities registered under Section 12(b) of the Exchange Act. We estimate that there are approximately 13 listed investment companies, including business development companies, that may be considered small entities.

D. Reporting, Recordkeeping, and Other Compliance Requirements

Under the proposals, the exchanges will be directed to prohibit the listing of an equity security of an issuer that does not comply with Section 10D's requirements concerning development and implementation of a policy requiring recovery of erroneously awarded incentive-based compensation, and disclosure of that policy. Large and small entities would be subject to the same recovery and disclosure requirements.

Proposed Rule 10D–1 would require exchanges to adopt listing standards that would require a listed issuer (including a small entity) to develop and implement a policy providing that, in the event that the issuer is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement, the issuer will recover from any of its current or former executive officers who received incentive-based compensation during the preceding three-year period based on the erroneous data, any such compensation in excess of what would have been paid under the accounting restatement.

If during the last completed fiscal year, either a restatement was completed that required recovery of excess incentive-based compensation pursuant to the listed small entity's compensation recovery policy, or there was an outstanding balance of excess incentive-based compensation from the application of the policy to a prior restatement, proposed Item 402(w) would require the listed small entity to disclose and provide in block-text tagged XBRL format:

- For each restatement,
  - The date on which the listed issuer was required to prepare an accounting restatement;
  - The aggregate dollar amount of excess incentive-based compensation attributable to the restatement; and
  - The aggregate dollar amount of excess incentive-based compensation that remained outstanding as of the end of the last completed fiscal year;
- The name of each person subject to recovery of excess incentive-based compensation attributable to an accounting restatement, if any, from whom during the last completed fiscal year the listed small entity decided not to pursue recovery, the amount forgone from each such person, and a brief description of the listed small entity's reasons for not pursuing recovery; and
- The name of, and amount due from, each person from whom, at the end of its last completed fiscal year, excess incentive-based compensation had been outstanding for 180 days or longer since the date the small entity determined the amount the person owed.

In addition, proposed Item 601(b)(96) and the corresponding amendment to Form N–CSR would require a listed

[346] Senate Report at 135–36.

[347] 5 U.S.C. 601(6).

[348] 17 CFR 242.601.

[349] 17 CFR 240.0–10(e).

[350] 17 CFR 230.157.

[351] 17 CFR 240.0–10(a).

[352] 17 CFR 270.0–10(a).

small entity to file, as an exhibit to its Exchange Act annual report or, in the case of a listed registered management investment company, its Form N–CSR annual report, its policy regarding the recovery of erroneously awarded incentive-based compensation.

The proposals will impose additional requirements on small entities in order to comply with the new listing standards and to collect, record and report the disclosures. For example, it can reasonably be expected that listed small entities would need to engage the professional services of attorneys to develop their recovery policies and would also need the services of both attorneys and accountants to implement those policies in the event of an accounting restatement. Such services will likely be needed to compute recoverable amounts, especially for incentive-based compensation based on stock price or total shareholder return metrics. Small entities also will incur costs to tag the required disclosures in XBRL format and may need to engage the services of outside professionals to assist with this process.

Our existing disclosure rules require smaller reporting companies to provide compensation information for named executive officers for the last two completed fiscal years in the Summary Compensation Table pursuant to Item 402(n) of Regulation S–K. We also believe that small entities do not typically grant their executive officers complex incentive-based compensation awards or use many different types of incentive-based compensation awards, which would significantly minimize the impact of the proposal, including the proposed reporting requirements, on small entities. To the extent a small entity may not currently be required to disclose the information the proposals require in the event there is a restatement and the restatement requires application of the small entity's recovery policy, this information should be readily available to the small entity as it controls how it implements its recovery policy. Where a small entity may be required to disclose this type of information in such filings pursuant to Item 404(a) of Regulation S–K, the proposed new instruction to Item 404 will provide that Item 404 disclosure is not required if the transaction involves the recovery of excess incentive-based compensation that is disclosed pursuant to Item 402(w).

In addition, we believe that the impact of the proposals on small entities will be lessened because the proposals apply only to listed issuers, and the quantitative listing standards applicable to issuers listing securities on an exchange, such as market capitalization, minimum revenue, and shareholder equity requirements, will serve to limit the number of small entities that would be affected.

E. Duplicative, Overlapping or Conflicting Federal Rules

As noted above, other statutes and rules administered by the Commission address the recovery of executive compensation. Section 304 of SOX provides for recovery of executive compensation when there has been material noncompliance of the issuer, as a result of misconduct, with any financial reporting measure. In addition, existing CD&A disclosure requirements call for disclosure of an issuer's policies and decisions regarding recovery of executive compensation in the event of an accounting restatement, to the extent material. Outside of the federal securities laws, EESA contains an executive compensation recovery provision applicable to financial institutions that sell troubled assets to the Secretary of the Treasury under TARP. As explained above, the proposed rule and rule amendments are generally broader in scope, and more specific in detail, than these existing provisions. For example, the proposed rule and rule amendments—unlike Section 304 of SOX—would require recovery in the event of an accounting restatement regardless of issuer misconduct. Similarly, the clawback provisions in EESA apply only to financial institutions that sold troubled assets to and have not repaid the Treasury, whereas the proposed rules apply to all listed issuers. Thus, although there may be some overlap between the proposed rule and rule amendments and these existing provisions, we do not believe the proposed rule and rule amendments would duplicate or conflict with other federal rules or statutes.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the proposed disclosure amendments, we considered the following alternatives:

- Clarifying, consolidating or simplifying compliance and reporting requirements under the rules for small entities;
- Exempting small entities from all or part of the requirements; and
- Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities.

In some respects, we have used performance standards in crafting the proposals. Specifically:

- Proposed Rule 10D–1 uses a standard-based definition of ''incentive based compensation'' subject to recovery;
- Proposed Rule 10D–1 provides boards of directors with limited discretion to determine whether and how much compensation to pursue and broader discretion to determine the means of recovery; and
- Proposed Rule 10D–1 adopts a standard-based approach to determining the amount of excess incentive-based compensation subject to recovery.

We believe that high quality financial reporting is important for promoting investor confidence in the financial markets. The proposed rule and rule amendments would further this objective by requiring that all listed issuers have policies requiring the recovery of executive compensation that was received based on material noncompliance with financial reporting requirements. The disclosure requirements in the proposed rule and rule amendments would require clear disclosure of a listed issuer's policy on recovery of incentive-based compensation, and provide investors with useful information regarding the application of that policy. We believe that our proposed rule and rule amendments will promote consistent compliance with recovery obligations and related disclosure across all listed issuers without unduly burdening small entities. We note that the proposal provides issuers flexibility to forgo recovery in circumstances where the costs of enforcing recovery would exceed the recoverable amounts. This will help to limit costs for all issuers subject to the rule, including small entities.

Although we preliminarily believe that an exemption for small entities from coverage of the proposals would not be appropriate, we seek comment on whether we should exempt small entities from any of the proposed requirements or scale the proposed disclosure amendments to reflect the characteristics of small entities and the needs of their investors.[353]

At this time, we do not believe that different compliance methods or timetables for small entities would be appropriate. The proposals are intended to further the statutory goal of assuring that executive officers do not retain

[353] See Sections II.A.1 and II.D, above, and related requests for comment.

incentive-based compensation that they received erroneously. The specific disclosure requirements in the proposals will promote consistent disclosure among all issuers, including small entities. Separate compliance requirements or timetables for small entities could interfere with achieving the goals of the statute and our proposals. Nevertheless, we solicit comment on whether different compliance requirements or timetables for small entities would be appropriate, and consistent with the purposes of Section 954 of the Act.[354]

G. Solicitation of Comments

We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding:

- How the proposed rule and rule amendments can achieve their objective while lowering the burden on small entities;
- The number of small entities that may be affected by the proposed rule and rule amendments;
- Whether small entities should be exempt from the rule and rule amendments;
- The existence or nature of the potential impact of the proposed amendments on small entities discussed in the analysis; and
- How to quantify the impact of the proposed rule and rule amendments.

Respondents are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed rule and rule amendments are adopted, and will be placed in the same public file as comments on the proposed rule and rule amendments themselves.

VII. Statutory Authority and Text of the Proposed Amendments Amendments

The amendments contained in this release are being proposed under the authority set forth in Sections 6, 7, 10, and 19(a) of the Securities Act, Sections 10D, 13, 14, 23(a) and 36 of the Exchange Act, and Sections 20, 30, and 38 of the Investment Company Act of 1940.

List of Subjects in 17 CFR Parts 229, 240, 249 and 274

Reporting and recordkeeping requirements, Securities, Investment companies.

[354] See Section II.F, above, and related requests for comment.

Text of the Proposed Amendments

For the reasons set out in the preamble, the Commission proposes to amend title 17, chapter II, of the Code of Federal Regulations as follows:

PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S–K

■ 1. The general authority citation for part 229 is revised to read as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z–2, 77z–3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 777iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78j–3, 78*l,* 78m, 78n, 78n–1, 78o, 78u–5, 78w, 78*ll,* 78mm, 80a–8, 80a–9, 80a–20, 80a–29, 80a–30, 80a–31(c), 80a–37, 80a–38(a), 80a–39, 80b–11, and 7201 *et seq.;* and 18 U.S.C. 1350.

* * * * *

■ 2. Section 229.402, as proposed to be amended at 78 FR 60559 [Oct. 1, 2013] and 80 FR 26329 [May 7, 2015], is further amended by:

■ a. Revising paragraph (a)(1);

■ b. Adding Instruction 5 to paragraph (c);

■ c. Adding Instruction 5 to paragraph (n); and

■ d. Adding paragraph (w).

The revision and additions read as follows:

§ 229.402 (Item 402) Executive compensation.

(a) * * *

(1) *Treatment of foreign private issuers.* A foreign private issuer will be deemed to comply with this Item if it provides the information required by Items 6.B, 6.E.2 and 6.F of Form 20–F (17 CFR 240.220f), with more detailed information provided if otherwise made publicly available or required to be disclosed by the issuer's home jurisdiction or a market in which its securities are listed or traded, or paragraph (17) of General Instruction B of Form 40–F (17 CFR 240.240f), as applicable. A foreign private issuer that elects to provide domestic Item 402 disclosure shall provide the disclosure required by Item 402(w) in its annual report or registration statement, as applicable.

* * * * *

(c) * * *

Instructions to Item 402(c). * * *

5. Any amounts recovered pursuant to a listed registrant's erroneously awarded compensation recovery policy shall reduce the amount reported in the applicable Summary Compensation Table column for the fiscal year in which the amount recovered initially was reported as compensation, and shall be identified by footnote.

* * * * *

(n) * * *

Instructions to Item 402(n). * * *

5. Any amounts recovered pursuant to the erroneously awarded compensation recovery policy of a smaller reporting company that is a listed registrant shall reduce the amount reported in its applicable Summary Compensation Table column for the fiscal year in which the amount recovered initially was reported as compensation, and shall be identified by footnote.

* * * * *

(w) *Disclosure of a listed registrant's action to recover erroneously awarded compensation.* If at any time during the last completed fiscal year either a restatement that required recovery of excess incentive-based compensation pursuant to the listed registrant's compensation recovery policy was completed or there was an outstanding balance of excess incentive-based compensation from the application of the policy to a prior restatement, the listed registrant shall provide the following information:

(1) For each restatement:

(i) The date on which the listed registrant was required to prepare an accounting restatement, as defined in 17 CFR 240.10D–1(c)(2);

(ii) The aggregate dollar amount of excess incentive-based compensation attributable to such accounting restatement;

(iii) The estimates that were used in determining the excess incentive-based compensation attributable to such accounting restatement, if the financial reporting measure related to a stock price or total shareholder return metric; and

(iv) The aggregate dollar amount of excess incentive-based compensation that remains outstanding at the end of the last completed fiscal year;

(2) If during the last completed fiscal year the listed registrant decided not to pursue recovery from any individual subject to recovery of excess incentive-based compensation attributable to an accounting restatement, for each such individual, the name and amount forgone and a brief description of the reason the listed registrant decided in each case not to pursue recovery;

(3) The name of each individual from whom, as of the end of the last completed fiscal year, excess incentive-based compensation had been outstanding for 180 days or longer since the date the issuer determined the amount the individual owed, and the

dollar amount of outstanding excess incentive-based compensation due from each such individual; and

(4) The disclosure required to be provided pursuant to this paragraph (w) shall appear with, and in the same format as, the rest of the disclosure required to be provided pursuant to this Item 402 and, in addition, shall be electronically formatted using the eXtensible Business Reporting Language (XBRL) interactive data standard in accordance with the EDGAR Filer Manual (17 CFR 232.11) as an exhibit to definitive Schedule 14A (17 CFR 240.14a–101) or definitive Schedule 14C (17 CFR 240.14c–101), as applicable, and Form 10–K (17 CFR 249.310). The XBRL format disclosure required to be provided pursuant this paragraph (w) must be block-text tagged.

Instructions to Item 402(w).

1. A *listed registrant* is a registrant that had a class of securities listed on a national securities exchange registered pursuant to section 6 of the Exchange Act (15 U.S.C. 78f) or a national securities association registered pursuant to section 15A of the Exchange Act (15 U.S.C. 78o–3) at any time during its last completed fiscal year.

2. A *compensation recovery policy* is the policy required by the listing standards adopted pursuant to 17 CFR 240.10D–1.

3. *Excess incentive-based compensation* is the erroneously awarded compensation computed as provided in 17 CFR 240.10D–1(b)(1)(iii) and the applicable listing standards for the listed registrant's securities.

4. For Item 402(w)(1), if the aggregate dollar amount of excess incentive-based compensation has not yet been determined, disclose this fact and explain the reason(s).

5. The information required by Item 402(w) must be disclosed only in proxy or information statements that call for Item 402 disclosure and the listed registrant's annual report on Form 10–K. The information required by this Item 402(w) will not be deemed to be incorporated by reference into any filing under the Securities Act, except to the extent that the listed registrant specifically incorporates it by reference.

* * * * *

■ 3. Amend § 229.404 by:

■ a. Removing ''or'' at the end of Instruction 5.a.i. to the Instructions to Item 404(a);

■ b. Removing the ''.'' and adding in its place '';or'' in Instruction 5.a.ii. to the Instructions to Item 404(a); and

■ c. Adding Instruction 5.a.iii. to the Instructions to Item 404(a).

The addition reads as follows:

§ 229.404 (Item 404) Transactions with related persons, promoters and certain control persons.

* * * * *

Instructions to Item 404(a). * * *

5.a. * * *

iii. The transaction involves the recovery of excess incentive-based compensation, as defined in Instruction 3 to § 229.402(w), that is disclosed pursuant to Item 402(w) (§ 229.402(w)).

* * * * *

■ 4. Amend § 229.601 adding paragraphs (96) and (97) to the exhibit table in paragraph (a) and adding paragraphs (b)(96) and (97) to read as follows:

§ 229.601 (Item 601) Exhibits.

(a) * * *

EXHIBIT TABLE

	Securities Act Forms										Exchange Act Forms					
	S–1	S–3	SF–1	SF–3	S–4[1]	S–8	S–11	F–1	F–3	F–4[1]	10	8–K[2]	10–D	10–Q	10–K	ABS–EE
* * *	*			*				*			*					
(96) *Listed Registrant Policy Relating to Recovery of Erroneously Awarded Compensation*	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	X	.....
(97) *Listed Registrant Compensation Recovery Disclosure under Item 402(w) of Regulation S–K in XBRL Electronic Format*	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	X	.....
* * *	*			*				*			*					

[1] An exhibit need not be provided about a company if: (1) With respect to such company an election has been made under Form S–4 or F–4 to provide information about such company at a level prescribed by Form S–3 or F–3; and (2) the form, the level of which has been elected under Form S–4 or F–4, would not require such company to provide such exhibit if it were registering a primary offering.

[2] A Form 8–K exhibit is required only if relevant to the subject matter reported on the Form 8–K report. For example, if the Form 8–K pertains to the departure of a director, only the exhibit described in paragraph (b)(17) of this section need be filed. A required exhibit may be incorporated by reference from a previous filing.

(b) * * *

(96) *Listed Registrant Policy Relating to Recovery of Erroneously Awarded Compensation.* A listed registrant must provide as an exhibit to its Exchange Act annual report the policy required by the applicable listing standards adopted pursuant to 17 CFR 240.10D–1. For purposes of this Item, a *listed registrant* is a registrant that had a class of securities listed on a national securities exchange registered pursuant to section 6 of the Exchange Act (15 U.S.C. 78f) or a national securities association registered pursuant to section 15A of the Exchange Act (15 U.S.C. 78o–3) at any time during its last completed fiscal year.

(97) *Listed Registrant Compensation Recovery Disclosure under Item 402(w) of Regulation S–K in XBRL Electronic Format.* The compensation recovery disclosure required to be provided by a listed registrant under Item 402(w) of Regulation S–K (§ 229.402(w)) in electronic format using the XBRL interactive data standard in accordance with the EDGAR Filer Manual (17 CFR 232.11). The exhibit must be block-text tagged.

* * * * *

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 5. The authority citation for part 240 is revised to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c–3, 78c–5, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78j–4, 78k, 78k–1, 78*l*, 78m, 78n, 78n–1, 78*o*, 78*o*–4, 78*o*–10, 78p, 78q, 78q–1, 78s, 78u–5, 78w, 78x, 78*ll*, 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, 7201 *et seq.*, and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C.5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111–203, 939A, 124 Stat.1376 (2010), unless otherwise noted.

* * * * *

■ 6. Add § 240.10D–1 to read as follows:

§ 240.10D–1—Listing standards relating to recovery of erroneously awarded compensation.

(a) Pursuant to section 10D(a) of the Act (15 U.S.C. 78j–4(a)):

(1) *National securities exchanges and associations.* The rules of each national securities exchange registered pursuant to section 6 of the Act (15 U.S.C. 78f) and each national securities association registered pursuant to section 15A of the Act (15 U.S.C. 78o–3), to the extent such national securities association lists securities in an automated inter-dealer quotation system must, in accordance with the provisions of this section, prohibit the initial or continued listing of any security of an issuer that is not

in compliance with the requirements of any portion of paragraph (b) or (c) of this section.

(2) *Implementation.* (i) Each national securities exchange and national securities association that lists securities must file with the Commission, no later than 90 days after publication of this section in the **Federal Register,** proposed rules or rule amendments that comply with this section. Such rules or rule amendments that comply with this section must be approved by the Commission and be effective no later than one year after publication of this section in the **Federal Register**.

(ii) Each listed issuer shall adopt the recovery policy required by this section no later than 60 days following the effective date of the listing standard referenced in paragraph (a)(2)(i) of this section. Each listed issuer shall comply with that recovery policy for all incentive-based compensation received by executive officers on or after the effective date of this section that results from attainment of a financial reporting measure based on or derived from financial information for any fiscal period ending on or after the effective date of this section. Each listed issuer shall provide the required disclosures in the applicable Commission filings required on or after the effective date of the listing standard referenced in paragraph (a)(2)(i) of this section.

(b) *Required standards.* The requirements of this section are as follows:

(1) *Recovery of erroneously awarded compensation.* The issuer shall adopt and comply with a written policy providing 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 the amount of erroneously awarded incentive-based compensation as provided below. The issuer shall file all disclosures with respect to such recovery policy in accordance with the requirements of the federal securities laws.

(i) To be subject to the issuer's recovery policy, incentive-based compensation:

(A) Must have been received while the issuer has a class of securities listed on a national securities exchange or a national securities association; and

(B) Must have been received by an individual who served as an executive officer of the issuer at any time during the performance period for that incentive-based compensation.

(ii) The issuer's recovery policy shall apply to any incentive-based compensation received during the three completed fiscal years immediately preceding the date that the issuer is required to prepare a restatement of its previously issued financial statements to correct a material error. In addition to these last three completed fiscal years, the recovery policy shall apply to any transition period (that results from a change in the issuer's fiscal year) within or immediately following those three completed fiscal years. However, a transition period that comprises a period of nine to 12 months would be deemed a completed fiscal year. A ''transition period'' refers to the period between the last day of the issuer's previous fiscal year end and the first day of its new fiscal year. An issuer's obligation to recover excess incentive-based compensation is not dependent on if or when the restated financial statements are filed.

(iii) The amount of incentive-based compensation subject to the issuer's recovery policy (the ''erroneously awarded compensation'') shall be the amount of incentive-based compensation received that exceeds the amount of incentive-based compensation that otherwise would have been received had it been determined based on the accounting restatement, and shall be computed without regard to any taxes paid. For incentive-based compensation based on stock price or total shareholder return, where the amount of erroneously awarded compensation is not subject to mathematical recalculation directly from the information in an accounting restatement:

(A) The amount shall be based on a reasonable estimate of the effect of the accounting restatement on the stock price or total shareholder return upon which the incentive-based compensation was received; and

(B) The issuer shall maintain documentation of the determination of that reasonable estimate and provide such documentation to the exchange or association.

(iv) The issuer must recover erroneously awarded compensation in compliance with its recovery policy except to the extent that it would be impracticable to do so. Recovery would be impracticable only if the direct expense paid to a third party to assist in enforcing the policy would exceed the amount to be recovered, or if recovery would violate home country law. Before concluding that it would be impracticable to recover any amount of erroneously awarded compensation based on expense of enforcement, the issuer must first make a reasonable attempt to recover that erroneously awarded compensation. The issuer shall document such reasonable attempt(s) to recover, and provide that documentation to the exchange or association. Before concluding that it would be impracticable to recover any amount of erroneously awarded compensation based on violation of home country law, the issuer must obtain an opinion of home country counsel, not unacceptable to the applicable national securities exchange or association, that recovery would result in such a violation, and shall provide such opinion to the exchange or association. In addition, the home country law must have been adopted in such home country prior to the date of publication in the **Federal Register** of proposed Rule 10D–1. In either case, the issuer's committee of independent directors responsible for executive compensation decisions, or in the absence of such a committee, a majority of the independent directors serving on the board, shall make any determination that recovery would be impracticable.

(v) The issuer is prohibited from indemnifying any executive officer or former executive officer against the loss of erroneously awarded compensation.

(vi) An issuer that has been delisted from any national securities exchange or national securities association for failing to comply with the recovery policy required by this section may not list its securities on any national securities exchange or national securities association until the issuer comes into compliance with that policy.

(2) *General exemptions.* The requirements of this section shall not apply to the listing of:

(i) A security futures product cleared by a clearing agency that is registered pursuant to section 17A of the Act (15 U.S.C. 78q–1) or that is exempt from the registration requirements of section 17A(b)(7)(A) (15 U.S.C. 78q–1(b)(7)(A)).

(ii) A standardized option, as defined in § 240.9b–1(a)(4), issued by a clearing agency that is registered pursuant to section 17A of the Act (15 U.S.C. 78q–1).

(iii) Any security issued by a unit investment trust, as defined in 15 U.S.C. 80a–4(2).

(iv) Any security issued by a management company, as defined in 15 U.S.C. 80a–4(3), that is registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8), if such management company has not awarded incentive-based compensation to any executive officer of the company in any of the last three fiscal years, or in the case of a company that has been listed for less than three fiscal years, since the listing of the company.

(c) *Definitions.* Unless the context otherwise requires, all terms used in this section have the same meaning as in the Act and the rules and regulations thereunder. In addition, unless the context otherwise requires, the following definitions apply for purposes of this section:

(1) *Accounting restatement.* For purposes of this rule, an accounting restatement is 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.

(2) *Date on which an issuer is required to prepare an accounting restatement.* For purposes of Section 10D of the Act (15 U.S.C. 78j–4), the date on which an issuer is required to prepare an accounting restatement is the earlier to occur of:

(i) 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

(ii) 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.

Note to paragraph (c)(2): The date specified in paragraph (c)(2)(i) of this section generally is expected to coincide with the occurrence of the event described under Item 4.02(a) of Exchange Act Form 8–K (17 CFR 249.308). Neither date specified in paragraph (c)(2) of this section is predicated on if or when a Form 8–K is filed.

(3) *Executive officer.* For purposes of Section 10D of the Act (15 U.S.C. 78j–4), an *executive officer* is 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 (such as sales, administration or finance), 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(s) or subsidiaries shall be deemed executive officers of the issuer if they perform such policy making functions for the issuer. In addition, when the issuer is a limited partnership, officers or employees of the general partner(s) who perform policy-making functions for the limited partnership are deemed officers of the limited partnership. When the issuer is a trust, officers or employees of the trustee(s) who perform policy-making functions for the trust are deemed officers of the trust.

Note to paragraph (c)(3): *Policy-making function* is not intended to include policy-making functions that are not significant. If pursuant to Item 401(b) of Regulation S–K (§ 229.401(b)) the issuer identifies a person as an executive officer, it is presumed that the Board of Directors has made that judgment and that the persons so identified are the executive officers for purposes of Section 10D of the Act (15 U.S.C. 78j–4), as are such other persons enumerated in this paragraph (c)(3) but not in Item 401(b).

(4) *Incentive-based compensation.* For purposes of Section 10D (15 U.S.C. 78j–4), *incentive-based compensation* is any compensation that is granted, earned or vested based wholly or in part upon the attainment of a financial reporting measure. Financial reporting measures are measures that are determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements, any measures that are derived wholly or in part from such measures, and stock price and total shareholder return. A financial reporting measure need not be presented within the financial statements or included in a filing with the Commission.

(5) *Material noncompliance.* For purposes of Section 10D (15 U.S.C. 78j–4), a restatement to correct an error that is material to previously issued financial statements shall be deemed to result from material noncompliance of the issuer with a financial reporting requirement under the securities laws.

(6) *Received.* For purposes of Section 10D (15 U.S.C. 78j–4), incentive-based compensation is deemed received in the issuer's fiscal period during which the financial reporting measure specified in the incentive-based compensation award is attained, even if the payment or grant of the incentive-based compensation occurs after the end of that period.

■ 7. Amend Section 240.14a–101, by adding Item 22(b)(20) and Item 25 to read as follows:

§ 240.14a–101 Schedule 14A. Information required in proxy statement.

SCHEDULE 14A INFORMATION

* * * * *

Item 22. * * *

(b) * * *

(20) In the case of a Fund that is an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a) that is required to develop and implement a policy regarding the recovery of erroneously awarded compensation pursuant to § 240.10D–1(b)(1), if at any time during the last completed fiscal year either a restatement that required recovery of excess incentive-based compensation pursuant to the Fund's compensation recovery policy was completed or there was an outstanding balance of excess incentive-based compensation from the application of the policy to a prior restatement, the Fund shall provide the following information:

(i) For each restatement:

(A) The date on which the Fund was required to prepare an accounting restatement, as defined in § 240.10D–1(c)(2);

(B) The aggregate dollar amount of excess incentive-based compensation attributable to such accounting restatement;

(C) The estimates that were used in determining the excess incentive-based compensation attributable to such accounting restatement, if the financial reporting measure related to a stock price or total shareholder return metric; and

(D) The aggregate dollar amount of excess incentive-based compensation that remains outstanding at the end of the last completed fiscal year;

(ii) If during the last completed fiscal year the Fund decided not to pursue recovery from any individual subject to recovery of excess incentive-based compensation attributable to an accounting restatement, for each such individual, the name and amount forgone and a brief description of the reason the Fund decided in each case not to pursue recovery; and

(iii) The name of each individual from whom, as of the end of the last completed fiscal year, excess incentive-based compensation had been outstanding for 180 days or longer since the date the issuer determined the amount the individual owed, and the dollar amount of outstanding excess incentive-based compensation due from each such individual.

Instructions to paragraph 22(b)(20).

1. Information provided under this paragraph is deemed to satisfy the requirements of paragraphs (b)(8) and (b)(11) of Item 22 with respect to the recovery of erroneously awarded compensation pursuant to § 240.10D–1(b)(1).

2. A *compensation recovery policy* is the policy required by the listing standards adopted pursuant to § 240.10D–1.

3. Excess incentive-based compensation'' is the erroneously awarded compensation computed as provided in § 240.10D–1(b)(1)(iii) and the applicable listing standards for the Fund's securities.

4. If the aggregate dollar amount of excess incentive-based compensation has not yet been determined, disclose this fact and explain the reason(s).

* * * * *

Item 25. Exhibits.

Provide the information required to be disclosed by Item 402(w) of Regulation S–K (17 CFR 229.402(w)), or Item 22(b)(20) of this Schedule 14A, in an exhibit to this Schedule 14A electronically formatted using the eXtensible Business Reporting Language (XBRL) interactive data standard in accordance with the EDGAR Filer Manual (17 CFR 232.11). The exhibit must be block-text tagged.

* * * * *

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

■ 8. The authority citation for part 249 is revised to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78a *et seq.,* 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78j–3, 78*l,* 78m, 78n, 78n–1, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll,* 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4 80b–11, and 7201 *et seq.;* 12 U.S.C. 5461 *et seq.;* and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

* * * * *

■ 9. Amend Form 20–F (referenced in § 249.220f) by adding Item 6.F and Instructions to Item 6.F, and adding Instruction 17 to the Instructions as to Exhibits, of Form 20–F, to read as follows:

Note: The text of Form 20–F does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM 20–F

* * * * *

Item 6. Directors, Senior Management and Employees

* * * * *

F. *Disclosure of a listed issuer's action to recover erroneously awarded compensation.* If at any time during the last completed fiscal year either a restatement that required recovery of excess incentive-based compensation pursuant to the listed issuer's compensation recovery policy was completed or there was an outstanding balance of excess incentive-based compensation from the application of the policy to a prior restatement, the listed issuer shall, in its annual report on Form 20–F, provide the following information:

(1) For each restatement:

(i) The date on which the listed issuer was required to prepare an accounting restatement, as defined in Rule 10D–1(c)(2) under the Exchange Act (17 CFR 240.10D–1(c)(2));

(ii) The aggregate dollar amount of excess incentive-based compensation attributable to such accounting restatement;

(iii) The estimates that were used in determining the excess incentive-based compensation attributable to such accounting restatement, if the financial reporting measure related to a stock price or total shareholder return metric; and

(iv) The aggregate dollar amount of excess incentive-based compensation that remains outstanding at the end of the last completed fiscal year;

(2) If during the last completed fiscal year the listed issuer decided not to pursue recovery from any individual subject to recovery of excess incentive-based compensation attributable to an accounting restatement, for each such individual, the name and amount forgone and a brief description of the reason the listed issuer decided in each case not to pursue recovery; and

(3) The name of each individual from whom, as of the end of the last completed fiscal year, excess incentive-based compensation had been outstanding for 180 days or longer since the date the issuer determined the amount the individual owed, and the dollar amount of outstanding excess incentive-based compensation due from each such individual.

(4) The disclosure required to be provided by Item 6.F shall appear with, and in the same format as, the rest of the disclosure required to be provided by Item 6 and, in addition, shall be electronically formatted using the eXtensible Business Reporting Language (XBRL) interactive data standard in accordance with the EDGAR Filer Manual (17 CFR 232.11) as an exhibit to this Form. The XBRL format disclosure required to be provided by this Item 6.F must be block-text tagged.

Instructions to Item 6.F.

1. For purposes of this Item, a ''listed issuer'' is an issuer that had a class of securities listed on a national securities exchange registered pursuant to section 6(a) of the Exchange Act (15 U.S.C. 78f) or a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o–3) at any time during its last completed fiscal year.

2. A ''compensation recovery policy'' is the policy required by the listing standards adopted pursuant to Rule 10D–1 under the Exchange Act (17 CFR 240.10D–1).

3. ''Excess incentive-based compensation'' is the erroneously awarded compensation computed as provided in Rule 10D–1(b)(1)(iii) under the Exchange Act (17 CFR 240.10D–1(b)(1)(iii)) and the applicable listing standards for the listed issuer's securities.

4. If the aggregate dollar amount of excess incentive-based compensation has not yet been determined, disclose this fact and explain the reason(s).

5. The information required by Item 6.F must be disclosed only in annual reports and does not apply to registration statements on Form 20–F. The information required by this Item 6.F will not be deemed to be incorporated by reference into any filing under the Securities Act, except to the extent that the listed issuer specifically incorporates it by reference.

* * * * *

Item 7. Major Shareholders and Related Party Transactions

* * * * *

Instructions to Item 7.B * * *

4. Disclosure need not be provided pursuant to this Item if the transaction involves the recovery of excess incentive-based compensation that is disclosed pursuant to Item 6.F.

* * * * *

INSTRUCTIONS AS TO EXHIBITS

* * * * *

96. A listed issuer must provide as an exhibit to its Exchange Act annual report on Form 20–F the compensation recovery policy required by the applicable listing standards adopted pursuant to Rule 10D–1 under the Exchange Act (17 CFR 240.10D–1) . For purposes of this paragraph, a ''listed issuer'' is a registrant that had a class of securities listed on a national securities exchange registered pursuant to section 6 of the Exchange Act (15 U.S.C. 78f) or a national securities association registered pursuant to section 15A of the Exchange Act (15 U.S.C. 78o–3) at any time during its last completed fiscal year.

97. The compensation recovery disclosure is required to be provided by a listed issuer under Item 6.F in electronic format using the XBRL interactive data standard in accordance with the EDGAR Filer Manual (17 CFR 232.11). The exhibit must be block-text tagged. 17 through 95 and 98 through 99 [Reserved]

* * * * *

■ 10. Amend Form 40–F (referenced in § 249.240f) by adding paragraph (17) to General Instruction B and Instructions to paragraph (17) of General Instruction B to read as follows:

Note: The text of Form 40–F does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM 40–F

* * * * *

(17) *Recovery of erroneously awarded compensation.*

(a) A listed issuer shall include as exhibit 96 the compensation recovery policy required by the applicable listing standards adopted pursuant to Exchange Act Rule 10D–1 (17 CFR 240.10D–1).

(b) If at any time during the last completed fiscal year either a restatement that required recovery of excess incentive-based compensation pursuant to the listed issuer's compensation recovery policy was completed or there was an outstanding balance of excess incentive-based compensation from the application of the policy to a prior restatement, the listed issuer shall, in its annual report on Form 40–F, provide the following information:

(1) For each restatement:

(i) The date on which the listed issuer was required to prepare an accounting restatement, as defined in Exchange Act Rule 10D–1(c)(2) (17 CFR 240.10D–1(c)(2));

(ii) The aggregate dollar amount of excess incentive-based compensation attributable to such accounting restatement;

(iii) The estimates that were used in determining the excess incentive-based compensation attributable to such accounting restatement, if the financial reporting measure related to a stock price or total shareholder return metric; and

(iv) The aggregate dollar amount of excess incentive-based compensation that remains outstanding at the end of the last completed fiscal year;

(2) If during the last completed fiscal year the listed issuer decided not to pursue recovery from any individual subject to recovery of excess incentive-based compensation attributable to an accounting restatement, for each such individual, the name and amount forgone and a brief description of the reason the listed issuer decided in each case not to pursue recovery; and

(3) The name of each individual from whom, as of the end of the last completed fiscal year, excess incentive-based compensation had been outstanding for 180 days or longer since the date the issuer determined the amount the individual owed, and the dollar amount of outstanding excess incentive-based compensation due from each such individual.

(4) The disclosure required to be provided by paragraph (17) of General Instruction B shall appear with, and in the same format as generally required for, the rest of the disclosure required to be provided by General Instruction B and, in addition, shall be electronically formatted using the eXtensible Business Reporting Language (XBRL) interactive data standard in accordance with the EDGAR Filer Manual (17 CFR 232.11) as exhibit 97 to this Form. The XBRL format disclosure required to be provided by paragraph (17) of General Instruction B must be block-text tagged.

Instructions to paragraph (17).

1. For purposes of this paragraph, a ''listed issuer'' is an issuer that had a class of securities listed on a national securities exchange registered pursuant to section 6 of the Exchange Act (15 U.S.C. 78f) or a national securities association registered pursuant to section 15A of the Exchange Act (15 U.S.C. 78o–3) at any time during its last completed fiscal year.

2. A ''compensation recovery policy'' is the policy required by the listing standards adopted pursuant to Exchange Act Rule 10D–1 (17 CFR 240.10D–1).

3. ''Excess incentive-based compensation'' is the erroneously awarded compensation computed as provided in Exchange Act Rule 10D–1(b)(1)(iii) (17 CFR 240.10D–1(b)(1)(iii)) and the applicable listing standards for the listed issuer's securities.

4. If the aggregate dollar amount of excess incentive-based compensation has not yet been determined, disclose this fact and explain the reason(s).

5. The information required by paragraph (17) of General Instruction B must be disclosed only in annual reports and does not apply to registration statements on Form 40–F. The information required by this paragraph (17) will not be deemed to be incorporated by reference into any filing under the Securities Act, except to the extent that the listed issuer specifically incorporates it by reference.

* * * * *

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

■ 11. The general authority citation for Part 274 is revised to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78j–4, 78*l*, 78m, 78n, 78*o*(d), 80a–8, 80a–24, 80a–26, 80a–29, and Pub. L. 111–203, sec. 939A, 124 Stat. 1376 (2010), unless otherwise noted.

* * * * *

■ 12. Amend Form N–CSR (referenced in 17 CFR 274.128) by:

■ a. Revising General Instruction D;

■ b. Redesignating Item 12 as Item 13;

■ c. Adding new Item 12;

■ d. Redesignating paragraph (a)(2) of newly designated Item 13 (Exhibits) as paragraph (a)(4); and

■ e. Adding paragraphs (a)(2) and (a)(3) to redesignated Item 13 (Exhibits).

The additions read as follows:

Note: The text of Form N–CSR does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM N–CSR

* * * * *

GENERAL INSTRUCTIONS * * *

D. Incorporation by Reference

A registrant may incorporate by reference information required by Items 4, 5, 12, and 13(a)(1). No other Items of the Form shall be answered by incorporating any information by reference. The information required by Items 4, 5, and 12 may be incorporated by reference from the registrant's definitive proxy statement (filed or required to be filed pursuant to Regulation 14A (17 CFR 240.14a–1 *et seq.*)) or definitive information statement (filed or to be filed pursuant to Regulation 14C (17 CFR 240.14c–1 *et seq.*)) which involves the election of directors, if such definitive proxy statement or information statement is filed with the Commission not later than 120 days after the end of the fiscal year covered by an annual report on this Form. All incorporation by reference must comply with the requirements of this Form and the following rules on incorporation by reference: Rule 10(d) of Regulation S–K under the Securities Act of 1933 (17 CFR 229.10(d)) (general rules on incorporation by reference, which, among other things, prohibit, unless specifically required by this Form, incorporating by reference a document that includes incorporation by reference to another document, and limits incorporation to documents filed within the last 5 years, with certain exceptions); Rule 303 of Regulation S–T (17 CFR 232.303) (specific requirements for electronically filed documents); Rules 12b–23 and 12b–32 under the Exchange Act (additional rules on incorporation by reference for reports filed pursuant to Sections 13 and 15(d) of the Exchange Act); and Rules 0–4, 8b–23, and 8b–32 under the Investment Company Act of 1940 (17 CFR 270.0–4, 270.8b–23, and 270.8b–32) (additional rules on incorporation by reference for investment companies).

* * * * *

Item 12. Recovery of Erroneously Awarded Compensation

In the case of a registrant that is required to develop and implement a

policy regarding the recovery of erroneously awarded compensation pursuant to Rule 10D–1(b)(1) under the Exchange Act (17 CFR 240.10D–1), if at any time during the last completed fiscal year either a restatement that required recovery of excess incentive-based compensation pursuant to the registrant's compensation recovery policy was completed or there was an outstanding balance of excess incentive-based compensation from the application of the policy to a prior restatement, the registrant shall provide the following information:

(a) For each restatement:

(1) The date on which the registrant was required to prepare an accounting restatement, as defined in Rule 10D–1(c)(2) under the Exchange Act (17 CFR 240.10D–1(c)(2));

(2) The aggregate dollar amount of excess incentive-based compensation attributable to such accounting restatement;

(3) The estimates that were used in determining the excess incentive-based compensation attributable to such accounting restatement, if the financial reporting measure related to a stock price or total shareholder return metric; and

(4) The aggregate dollar amount of excess incentive-based compensation that remains outstanding at the end of the last completed fiscal year;

(b) If during the last completed fiscal year the registrant decided not to pursue recovery from any individual subject to recovery of excess incentive-based compensation attributable to an accounting restatement, for each such individual, the name and amount forgone and a brief description of the reason the registrant decided in each case not to pursue recovery; and

(c) The name of each individual from whom, as of the end of the last completed fiscal year, excess incentive-based compensation had been outstanding for 180 days or longer since the date the issuer determined the amount the individual owed, and the dollar amount of outstanding excess incentive-based compensation due from each such individual.

Instructions

1. The information required by this Item is only required in an annual report on Form N–CSR.

2. A ''compensation recovery policy'' is the policy required by the listing standards adopted pursuant to Rule 10D–1 under the Exchange Act (17 CFR 240.10D–1).

3. ''Excess incentive-based compensation'' is the erroneously awarded compensation computed as provided in Rule 10D–1(b)(1)(iii) under the Exchange Act (17 CFR 240.10D–1(b)(1)(iii)) and the applicable listing standards for the listed registrant's securities.

4. If the aggregate dollar amount of excess incentive-based compensation has not yet been determined, disclose this fact and explain the reason(s).

Item 13. Exhibits

(a) * * *

(2) Any policy required by the listing standards adopted pursuant to Rule 10D–1 under the Exchange Act (17 CFR 240.10D–1) by the registered national securities exchange or registered national securities association upon which the registrant's securities are listed.

Instruction to Paragraph (a)(2)

The exhibit required by this paragraph (a)(2) is only required in an annual report on Form N–CSR.

(3) Unless the information required by Item 12 is answered by incorporating by reference from the registrant's definitive proxy statement or definitive information statement pursuant to General Instruction D, provide the information required to be disclosed by Item 12 in an exhibit to this Form electronically formatted using the eXtensible Business Reporting Language (XBRL) interactive data standard in accordance with the EDGAR Filer manual (17 CFR 232.11). The exhibit must be block-text tagged.

Instruction to Paragraph (a)(3)

The exhibit required by this paragraph (a)(3) is only required in an annual report on Form N–CSR.

* * * * *

By the Commission.

Dated: July 1, 2015.

Brent J. Fields,

Secretary.

[FR Doc. 2015–16613 Filed 7–13–15; 8:45 am]

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