SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 229, 232, 240, 249, 270, and 274

[Release Nos. 33-11126; 34-96159; IC-34732; File No. S7-12-15]

RIN 3235-AK99

Listing Standards for Recovery of Erroneously Awarded Compensation

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting a new rule and rule amendments to implement Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), which added Section 10D to the Securities Exchange Act of 1934 ("Exchange Act"). In accordance with Section 10D of the Exchange Act, the final rules direct the national securities exchanges and associations that list securities to establish listing standards that require each issuer to develop and implement a policy providing for the recovery, in the event of a required accounting restatement, of incentive-based compensation received by current or former executive officers where that compensation is based on the erroneously reported financial information. The listing standards must also require the disclosure of the policy. Additionally, the final rules require a listed issuer to file the policy as an exhibit to its annual report and to include other disclosures in the event a recovery analysis is triggered under the policy.

DATES: The amendments are effective [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

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SUPPLEMENTARY INFORMATION: We are adopting amendments to:

Commission Reference		CFR Citation (17 CFR)
Regulation S-K	Item 10 through 1406	§§ 229.10 through 229.1406
	Item 402	§ 229.402
	Item 404	§ 229.404
	Item 601	§ 229.601
Regulation S-T	Rule 10 through 903	§§ 232.10 through 232.903
	Rule 405	§ 232.405
Exchange Act[1]	Rule 10D-1	§ 240.10D-1
	Schedule 14A	§ 240.14a-101
	Form 20-F	§ 249.220f
	Form 40-F	§ 249.240f
	Form 10-K	§ 249.310
Exchange Act and Investment Company Act of 1940 ("Investment Company Act")[2]	Form N-CSR	§§ 249.331 and 274.128
Investment Company Act	Rule 30a-2	§ 270.30a-2

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[1] 15 U.S.C. 78a *et seq*.

[2] 15 U.S.C. 80a-1 *et seq.*

I. Introduction and Background

Section 954 of the Dodd-Frank Act added 15 U.S.C. 78j-4 ("Section 10D") to the Exchange Act. Title 15 Section 78j-4 (a) of the U.S. Code ("Section 10D(a)") requires the Securities and Exchange Commission (the "Commission") to adopt rules directing the national securities exchanges[3] ("exchanges") and the national securities associations[4] ("associations") to prohibit the listing of any security of an issuer that is not in compliance with the requirements of 15 U.S.C. 78j-4(b) ("Section 10D(b)"). Section 10D(b) of the Exchange Act requires the

[3] A "national securities exchange" is an exchange registered as such under 15 U.S.C. 78f ("Section 6 of the Exchange Act"). 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, because the final rules exempt security futures products and standardized options from their scope, any registered national securities exchange that lists and trades only security futures products or standardized options is not required to file a rule change in order to comply.

[4] A "national securities association" is an association of brokers and dealers registered as such under 15 U.S.C. 78o-3 ("Section 15A of the Exchange Act"). 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 exchanges in this release. However, if any associations were to list securities, the rules would apply to them.

Commission to adopt rules directing the exchanges to establish listing standards that require each issuer to develop and implement a policy providing:

- 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
- 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 incentive-based compensation (including stock options awarded as compensation) that was received 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.

In seeking to implement this statutory mandate, we have been guided by the language, structure, and legislative history of Section 10D. As a part of the Dodd-Frank Act legislative process, in a 2010 report, the Senate Committee on Banking, Housing and Urban Affairs stated that "Section 954 [Section 10D] requires public companies to have a policy to recover money that they erroneously paid in incentive compensation to executive officers as a result of material noncompliance with accounting rules."[5] The Senate Report further clarified that application of the recovery policy mandated by Section 10D "does not require adjudication of misconduct in connection with the problematic accounting that required restatement."[6]

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[5] *See* Report of the Senate Committee on Banking, Housing, and Urban Affairs, S.3217, Report No. 111-176 at 135- 36 (Apr. 30, 2010) ("Senate Report") at 135.

[6] *Id*.

The Senate Report highlighted the Committee's belief that it is "unfair to shareholders for corporations to allow executive officers to retain compensation that they were awarded erroneously."[7] The language and legislative history of the Dodd-Frank Act make clear that Section 10D is premised on the notion that an executive officer should not retain incentive-based compensation that, had the issuer's accounting been correct in the first instance, would not have been received by the executive officer, regardless of any fault of the executive officer for the accounting errors. The Senate Report also indicates that shareholders should not "have to embark on costly legal expenses to recoup their losses" and that "executives must return monies that should belong to the shareholders."[8]

Informed by this legislative history, we read Section 10D to express a simple proposition: executive officers of exchange-listed issuers should not be entitled to retain incentive-based compensation that was erroneously awarded on the basis of materially misreported financial information that requires an accounting restatement. The statute thus mandates that exchange-listed issuers maintain policies to recover such compensation for the benefit of the issuers' owners—their shareholders. In light of the straightforward nature of the goal Congress sought to achieve, we have approached implementation of the statute with the view that discretion to implement and execute these mandated recovery policies generally should be limited.

For similar reasons, we believe Section 10D's mandated recovery policies were intended to apply broadly. Because Congress specifically referenced "incentive-based compensation (including stock options awarded as compensation)," we infer that it intended the provision to cover any incentive-based compensation that may be impacted by financial reporting. Further,

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[7] *Id*.

[8] *Id*.

Congress did not define "executive officers" narrowly by limiting the term to include only the named executive officers or another subset of executives; rather it appears that Congress intended the scope of the statute to reach more broadly to include all of an issuer's executive officers.[9] While this scope may result in recovery from officers who did not play a direct role in an accounting error or who did not help to set a "tone at the top" that affects financial reporting accuracy, we understand that effect to be consistent with the statutory purpose of recovering compensation erroneously paid to executive officers regardless of whether the executive officer directly contributed to the error.

In addition to the benefits and purposes that Congress identified when enacting Section 10D, our implementation of the statute has been informed by certain additional benefits of the recovery requirement. As discussed in Section IV.B., the recovery requirement may provide executive officers with an increased incentive to take steps to reduce the likelihood of inadvertent misreporting and will reduce the financial benefits to executive officers who choose to pursue impermissible accounting methods, which we expect will further discourage such behavior. These increased incentives may improve the overall quality and reliability of financial reporting, which further benefits investors. These additional benefits further support our view that the most appropriate means of implementing the Section 10D mandate is to require robust recovery policies that will help to ensure that executive officers at exchange-listed issuers do not retain the benefits of erroneously awarded incentive-based compensation.

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[9] While Section 10D applies broadly to all executive officers and Congress did not specify a subset of executive officers, the Senate Report makes clear it is not intended to apply to rank-and-file employees. *See* Senate Report at 136 ("This policy is required to apply to executive officers, a very limited number of employees, and is not required to apply to other employees").

On July 1, 2015, the Commission proposed a new rule, and rule and form amendments[10] to implement the provisions of Section 10D.[11] On October 14, 2021, the Commission reopened the comment period for the Proposing Release to allow interested persons further opportunity to analyze and comment upon the proposed rules in light of developments since the publication of the Proposing Release and the Commission's further consideration of the statutory mandate.[12] In the Reopening Release, the Commission stated that it was considering, and requested public comment on, certain revisions to the proposals included in the Proposing Release, including a broader interpretation of the statutory term "an accounting restatement due to material noncompliance."[13] The Commission re-opened the comment period again on June 8 2022, in connection with the addition to the comment file of a memorandum prepared by Commission staff providing additional analysis on compensation recovery policies and accounting restatements.[14] We have received numerous comment letters pursuant to our initiative to receive advance public comment in implementing the Dodd-Frank Act,[15] in response to the Proposing Release, and in response to the reopening releases.[16] Commenters broadly supported the

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[10] *See Listing Standards for Recovery of Erroneously Awarded Compensation*, Release No. 34-75342 (Jul. 1, 2015) [80 FR 41144 (July 14, 2015)] ("Proposing Release").

[11] Pub. L. No. 111-203, 124 Stat. 1900 (2010).

[12] *See Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation*, Release No. 34-93311 (Oct. 14, 2021) [86 FR 58232 (Oct. 21, 2021)] ("Reopening Release").

[13] *See generally*, Reopening Release.

[14] *See Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation*, Release No. 34-95057 (June 8, 2022) [87 FR 35938 (June 14, 2022)] ("Second Reopening Release"). *See also* Memorandum from the Division of Economic and Risk Analysis (June 8, 2022) (submitted to the comment file in connection with Second Reopening Release)("2022 staff memorandum").

[15] Comment letters related to the executive compensation provisions of the Dodd-Frank Act provided prior to the Proposing Release are *available at* http://www.sec.gov/comments/df-title-ix/executive-compensation/executive-compensation.shtml.

[16] Comment letters related to the Proposing Release, the Reopening Release, and the Second Reopening Release are *available at* https://www.sec.gov/comments/s7-12-15/s71215.htm. A comment letter from two members of Congress raised concerns about the Reopening Release. *See* comment letter from Sen. Pat Toomey and Sen. Richard Shelby, dated Feb. 1, 2022 ("Toomey/Shelby"). Specifically, the letter criticized the Commission for

objectives of the proposed rules, although commenters offered various recommendations and expressed various concerns regarding the proposed implementation. As discussed further below, after reviewing and considering the public comments and recommendations and guided by our understanding of the goal Congress was trying to achieve, we are adopting the proposed rules substantially as proposed, but with certain modifications to broaden the scope of covered restatements, clarify the rules, and address comments received on the proposals.

II. Discussion of Final Amendments

New Exchange Act Rule 10D-1 sets forth the listing requirements that exchanges and associations that list securities are directed to establish pursuant to Section 10D of the Exchange Act. Amendments to Regulation S-K, Form 10-K, Form 20-F, Form 40-F, and for certain investment companies, Form N-CSR and Schedule 14A, require disclosure of the listed issuer's policy on recovery of incentive-based compensation and information about actions taken pursuant to such recovery policy.

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reopening the comment period on the Proposing Release and seeking comment on a number of regulatory alternatives without updating the cost-benefit analysis and analysis required by 44 U.S.C. 3501 *et seq*. ("Paperwork Reduction Act" or "PRA") and 5 U.S.C. 601 *et seq*. ("Regulatory Flexibility Act" or "RFA") and urged the Commission to repropose the rulemaking. The letter asserted that the approach taken in the Reopening Release significantly impaired the public's ability to comment thoughtfully on the proposals and was inconsistent with 5 U.S.C. 551 through 559 ("Administrative Procedure Act"). In response to these concerns, we note that the Reopening Release included a robust discussion of the broader interpretation of the statutory term under consideration and certain potential changes and solicited comment on that interpretation and those potential changes. The 2022 staff memorandum in connection with the Second Reopening Release analyzed the benefits and costs of the potential changes. The 2022 staff memorandum also considered the impact on smaller registrants. Given the discussion included in the Proposing Release, the Reopening Release, the Second Reopening Release, and the 2022 staff memorandum, and in this adopting release, we believe the final rules satisfy the requirements of the Administrative Procedure Act and other applicable statutes and that a reproposal is unnecessary. Moreover, in response to both the Reopening and Second Reopening Releases, we received numerous comments from members of the public on the potential changes and additional disclosures, including comments on their economic effects, and we have considered those comments in adopting the final rules.

New Exchange Act Rule 10D-1 and the rule amendments adopted in this release supplement existing provisions[17] by directing the exchanges to establish listing standards that require issuers to:[18]

- Develop and implement written policies for recovery of incentive-based compensation based on financial information required to be reported under the securities laws, applicable to the issuers' executive officers, during the three completed fiscal years immediately preceding the date that the issuer is required to prepare an accounting restatement; and
- Disclose those compensation recovery policies in accordance with Commission rules, including providing the information in tagged data format.

To assure that issuers listed on different exchanges are subject to the same disclosure requirements regarding erroneously awarded compensation recovery policies, amendments to the Commission's disclosure rules require all issuers listed on any exchange to file their written compensation recovery policy as an exhibit to their annual reports,[19] to indicate by check boxes on their annual reports whether the financial statements of the registrant included in the filing

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[17] *See* 15 U.S.C. 7243 (providing that the chief executive officer ("CEO") and chief financial officer ("CFO") of an issuer must reimburse the issuer for bonus or other incentive-based or equity-based compensation resulting from an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct) and 17 CFR 229.402(b) (requiring disclosure of company policies and decisions regarding the adjustment or recovery of awards or payments to named executive officers in the issuer's Compensation Discussion and Analysis ("CD&A")). The CD&A disclosure requirement is principles-based in that it identifies the disclosure concept and provides several non-exclusive examples. Under 17 CFR 229.402(b)(1), companies must explain all material elements of their named executive officers' compensation by addressing mandatory principles-based topics in CD&A. 17 CFR 229.402(b)(2) sets forth nonexclusive examples of the kind of information that should be addressed in CD&A, if material.

[18] Exchanges may adopt listing standards with requirements that are more extensive than those of Rule 10D-1. Listed issuers may, of course, adopt policies more extensive than those called for by the listing standards, so long as those policies at a minimum satisfy the listing standards.

[19] *See* 17 CFR 229.601(b)(97), 17 CFR 240.14a-101, 17 CFR 249.220f, 17 CFR 249.240f, and 17 CFR 274.128 Item 19(a)(2).

reflect a correction of an error to previously issued financial statements and whether any such corrections are restatements that required a recovery analysis,[20] and to disclose any actions an issuer has taken pursuant to such recovery policy.[21]

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

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. 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.[22]

1. Proposed Amendments

The Commission proposed to require exchanges to apply the disclosure and recovery policy requirements to all listed issuers, with only limited exceptions. As Section 10D refers to "any security" of an issuer, the Commission proposed that the listing standards and other requirements apply without regard to the type of securities issued, including to issuers of listed debt or preferred securities that do not have listed equity.[23] The Commission did however

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[20] *See* 17 CFR 249.220f, 17 CFR 249.240f, and 17 CFR 249.310. *But see* Section II.D.3. regarding check box disclosure on 17 CFR 274.128.

[21] *See* 17 CFR 229.402(w) ("Item 402(w) of Regulation S-K"), 17 CFR 240.14a-101(b)(20), 17 CFR 249.220f Item 6.F., 17 CFR 249.240f Item 19, and 17 CFR 274.128 Item 18.

[22] In this regard, Section 10D differs from other Dodd Frank Act 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, to provide exemptions, or to take into account whether the requirements disproportionately burden small issuers.

[23] 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. *See* proposed Rule 10D-1(b)(1)(vi).

propose to exempt security futures products and standardized options because the Commission recognized that information about the compensation practices at the clearing agencies that issue these securities is less relevant to investors,[24] and to exempt the securities of certain registered investment companies from the proposed listing standards because the Commission recognized that the compensation structures of issuers of these securities render application of the rules unnecessary.[25]

The Commission did not propose to otherwise exempt categories of listed issuers, such as emerging growth companies ("EGCs"),[26] smaller reporting companies ("SRCs"),[27] foreign private issuers ("FPIs"),[28] and controlled companies.[29] The Commission further did not propose

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[24] "Equity security" as defined in 15 U.S.C. 78c(a)(11) includes any security future on any stock or similar security. A "security future" as defined in 15 U.S.C. 78c(a)(55) means "a contract of sale for future delivery of a single security or of a narrow-based security index." "Security futures product" as defined in 15 U.S.C. 78c(a)(56) and 7 U.S.C. 1a(32) include a security future or any put, call, straddle, option or privilege on any security future. Security futures products may be traded on exchanges registered under 15 U.S.C. 78f and associations registered under 15 U.S.C. 78o-3 without such securities being subject to the registration requirements of the Securities Act and the Exchange Act so long as they are cleared by a clearing agency that is registered under 15 U.S.C. 78q-1 or that is exempt from registration under 15 U.S.C. 78q-1(b)(7). *See* 15 U.S.C. 77c(a)(14), 15 U.S.C. 78l(a), 17 CFR 240.12h-1(e). Comparable regulatory treatment exists for standardized options, which are defined in 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. *See* 17 CFR 230.238, 17 CFR 240.12a-9, 17 CFR 240.12h-1(d).

[25] The Commission proposed to exempt the listing of any security issued by a registered management investment company if such 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. The Commission additionally proposed to exempt the listing of any security issued by a unit investment trust.

[26] *See* 15 U.S.C. 77b(a)(19) and 15 U.S.C. 78c(a)(80).

[27] *See* 17 CFR 240.12b-2.

[28] *See* 17 CFR 240.3b-4(c). The Commission did propose to permit a FPI to make a determination regarding impracticability to recover in limited circumstances where doing so would violate home country law. *See* Section II.C.3.b, of the Proposing Release and Section II.C.3.b. for a discussion of impracticability of recovery.

[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.

to grant the exchanges discretion to decide whether certain categories of securities should be exempted from the Section 10D listing standards.

2. Comments

We received substantial comment on whether certain classes of issuers and securities should be subject to the proposal. Some commenters supported the scope of issuers covered by the proposal.[30] Other commenters recommended that the Commission exercise its exemptive authority to exclude certain issuers and classes of securities from the requirements.[31]

A number of commenters expressed concern regarding application of the rules to FPIs,[32] and suggested that application of the rules could impose inconsistent standards[33] and questioned

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[30] *See, e.g.,* comment letters from American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO"); Americans for Financial Reform (Sept. 14, 2015) ("AFR 1"); Better Markets, Inc. (Sept. 14, 2015) ("Better Markets 1"); Council of Institutional Investors (Aug. 27, 2015) ("CII 1"); California Public Employees' Retirement System (Sept. 14, 2015) ("CalPERS 1"); CFA Institute (Sept. 14, 2015) ("CFA Institute 1"); Robert E. Rutkowski (Sept. 15, 2015) ("Rutkowski 1"); and State Board of Administration ("SBA"). Some of these commenters contended that investors deserve the same protections regardless of the category of listed issuer. *See* comment letters from AFL-CIO; CII 1; the Office of the Comptroller of the State of New York; and Public Citizen (Nov. 19, 2021) ("Public Citizen 2").

[31] *See, e.g.,* comment letters from American Bar Association Committee on Federal Regulation of Securities of the Section of Business Law (Feb. 11, 2016) ("ABA 1"); Davis Polk & Wardwell LLP (Sept. 11, 2015) ("Davis Polk 1"); Duane Morris LLP ("Duane"); Financial Services Roundtable ("FSR"); Freshfields Bruckhaus Deringer ("Freshfields"); Japanese Bankers Association ("Japanese Bankers"); Kaye Scholer LLP ("Kaye Scholer"); SAP SE ("SAP"); Sullivan & Cromwell LLP (Sept. 22, 2015) ("S&C 1"); TELUS Corporation ("TELUS"); and UBS Group AG ("UBS").

[32] *See, e.g.,* comment letters from ABA 1 (suggesting that the general presumption against the extraterritorial application of United States law, as well as the general principle of international comity, should apply); Davis Polk 1; Duane; FSR (noting the burden of having to comply with U.S.-based executive compensation governance in addition to home country laws); Freshfields; Japanese Bankers (suggesting that "a penalty on restatement of financial statements prepared in accordance with the home country accounting standard should be determined by judicial ruling of the home country, and should not be governed by the U.S. listing rules"); Kaye Scholer; SAP; S&C 1; TELUS; and UBS.

[33] *See, e.g.,* comment letters from the U.S. Chamber of Commerce Center for Capital Markets Competitiveness (Sept. 14, 2015) ("CCMC 1") (suggesting that "affected [issuers] may find themselves endeavoring to comply with contradictory laws in multiple jurisdictions creating conflicts that cannot be addressed with a single solution"); Freshfields (expressing concerns regarding potential conflicts between the proposed listing standard and home country rules and noting potential conflicts with home country laws, stock exchange requirements, or corporate governance arrangements); and S&C 1 (stating that "[r]equiring a non-U.S. issuer to comply with U.S. and home country requirements would upset the regulatory framework established by the home country and potentially impose inconsistent standards"). *See also* comment letter from Duane (suggesting the rule could force issuers to choose between violating home country law or the listing standards).

the feasibility of implementation by FPIs.[34] Some of these commenters recommended that the Commission unconditionally exempt FPIs,[35] noting that FPIs have been exempted from many of the Commission's executive compensation regulations and are not subject to Section 16 of the Exchange Act,[36] and that other U.S. listing standards permit FPIs to comply with home country standards rather than the U.S. listing standard requirements.[37] Commenters alternatively recommended that the Commission exempt FPIs where the home country has an appropriate governance regime or law governing erroneously awarded compensation.[38]

One commenter urged the Commission to exempt all registered investment companies unconditionally, rather than the proposed exemption for registered unit investment trusts ("UITs") and for registered management investment companies ("listed funds") that have not awarded incentive-based compensation in the last three fiscal years.[39] The commenter asserted

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[34] *See* comment letters from CCMC 1; and Kaye Scholer (suggesting that an issuer's home country has a more appropriate interest in determining whether companies domiciled there should be subject to a compensation recovery requirement). *See also* comment letters from ABA 1 (noting that such issuers generally adhere to IFRS, which sets forth criteria for determining when a restatement is required that differ from GAAP, such that applying the rule to FPIs may lead to inconsistent treatment among issuers); and Davis Polk 1.

[35] *See* comment letters from ABA 1; Davis Polk 1; Duane; FSR; Freshfields; Japanese Bankers; Kaye Scholer; SAP; S&C 1; TELUS; and UBS.

[36] *See, e.g.,* comment letter from FSR (noting that FPIs have been exempted from many of the executive compensation regulations enacted under the Dodd-Frank Act, as well as disclosure requirements under Item 402 of Regulation S-K, and further stating that because such issuers are not subject to Section 16, the proposed rules would require such issuers to design and implement new executive compensation governance structures).

[37] *See* comment letters from UBS (citing the NYSE Group, Inc. ("NYSE") audit committee independence rule); and Duane (citing Exchange Act Section 10C). *See also* comment letter in response to the Reopening Release from Cravath, Swaine & Moore LLP ("Cravath") (noting the burden placed on FPIs that may be subject to different corporate governance standards in their home countries).

[38] *See, e.g.,* comment letters from Freshfields; and TheCityUK (suggesting permitting compliance with home country provisions that provide for similarly rigorous disciplines meeting the same goals).

[39] *See* comment letter from Investment Company Institute (Sept. 14, 2015). ICI submitted a comment letter on the original proposal in 2015 as well as on the Reopening Release (Nov. 22, 2021). Because the letters largely made the same points, the letters are referred to collectively as if they were a single letter ("ICI"). Another commenter supported the Commission's proposed conditional exemption for listed funds, while also urging the Commission to exempt them and certain other issuers unconditionally, but without any further analysis supporting this recommendation for listed funds. *See* comment letter from FSR.

that the legislative history of the Dodd-Frank Act does not indicate that the purpose of Section 10D was to address abuses with respect to listed funds; that listed funds have been exempted from certain prior compensation-related rulemakings; and that listed fund financial statements are less complex than operating company financial statements, resulting in accounting restatements being rare for listed funds.[40] The commenter therefore believed that the costs to affected listed funds would outweigh the benefits. The commenter also stated that the proposal could affect more than the small number of internally managed listed funds that the Commission estimated in the proposal, because some externally managed listed funds may pay some or all of the funds' chief compliance officers' compensation.

Another commenter urged the Commission to extend the proposed conditional exemption to externally managed business development companies ("BDCs").[41] The commenter asserted that the same policy considerations supporting the conditional exemption for listed funds apply to externally managed BDCs, and that provisions of the Investment Advisers Act of 1940[42] and the Investment Company Act effectively prohibit these BDCs from offering certain incentive compensation plans to their officers.[43]

We received limited comment on the Commission's proposal to exempt security futures products and standardized options. One commenter generally supported the proposed exemption and no other commenters objected to the proposal to exempt security futures products and

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40 *See* comment letter from ICI.

41 *See* comment letter from Clifford Chance *et al*.

42 15 U.S.C. 80b-1 through 15 U.S.C. 80b-21.

43 *See* comment letter from Clifford Chance *et al*.

standardized options, or otherwise addressed this aspect of the proposal.[44] Some commenters recommended exemptions for debt-only issuers[45] and controlled companies.[46]

Some commenters expressed support for requiring recovery by SRCs and EGCs as proposed,[47] while others recommended that the Commission exempt SRCs and EGCs, citing the costs and burdens associated with imposing compensation recovery policies containing the detail and scope contemplated by the proposal.[48] As an alternative to exemption, these commenters recommended deferring compliance for these issuers.[49] In response to the Reopening Release, a

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44 *See* comment letter from ABA 1.

45 *See, e.g.,* comment letters from ABA 1; Davis Polk 1 (noting protections from the indenture contract and Trust Indenture Act, the ability to negotiate for indenture covenants, and that a wholly-owned subsidiary of a reporting company are not required to provide executive compensation disclosure); FSR (suggesting that the harm that the proposal is designed to address is immaterial to such investors and that a public parent issuer would have oversight over its executive compensation and financial statements); Jesse M. Fried ("Fried"); and Society for Corporate Governance (formerly Society of Corporate Secretaries & Governance Professionals) (Sept. 18, 2015) ("SCG 1"). *See also* comment letter in response to the Reopening Release from Davis Polk (Nov. 22, 2021) ("Davis Polk 3") (further noting that debt-only issuers are exempt from many rules related to executive compensation). In contrast, one commenter specifically opposed such an exemption. *See* comment letter from Better Markets 1.

46 *See* comment letters from Duane; and Fried (both suggesting that debt-only and controlled companies may have greater control over executive officers and can employ incentives, such as extra pay or threat of termination, that would dwarf the incentive effect of a potential compensation recovery).

47 *See, e.g.,* comment letters from Better Markets 1; CalPERS 1 (noting small issuers may offer substantial incentive compensation packages); Public Citizen (Sept. 14, 2015) ("Public Citizen 1") (suggesting such issuers lack the wider and potentially more vigilant shareholder base of larger companies); and SBA (recommending that strong governance practices should be applied at early growth stages). *See also* comment letter from CFA Institute 1 (suggesting it would not be appropriate or necessary to scale the proposed disclosure requirements for smaller or EGCs).

48 *See, e.g.,* comment letters from ABA 1 (further suggesting that such issuers should not be required to disclose their reasons for not pursuing recovery or the aggregate amount of excess compensation remaining outstanding at fiscal year-end); Compensia; Mercer; and National Association of Corporate Directors ("NACD"). *See also* Annual Report for Fiscal Year 2021: Office of the Advocate for Small Business Capital Formation ("2021 OASB Annual Report"), available at https://www.sec.gov/files/2021-OASB-Annual-Report.pdf, at 68 (recommending generally that in engaging in rulemaking that impacts small businesses, the Commission tailor the disclosure and reporting framework to the complexity and size of operations of companies, either by scaling obligations or delaying compliance for the smallest of the public companies, particularly as it pertains to potential new or expanded disclosure requirements).

49 *See, e.g.,* comment letters from ABA 1; Compensia; Mercer; and NACD.

number of commenters additionally noted the burdens on smaller issuers and recommended accommodations.[50]

3. Final Amendments

After considering the comments, we are adopting rules to require exchanges to apply the disclosure and compensation recovery policy requirements to all listed issuers,[51] with only limited exceptions, substantially as proposed.[52] Under the final rules, an issuer would be subject to delisting if it does not adopt and comply with its compensation recovery policy.[53] In a clarification to the proposal, 17 CFR 240.10D-1(a) as adopted provides that the requirements of Section 10D apply to each exchange and association to the extent such exchange or association lists securities. Accordingly, the requirements will not apply to exchanges that only trade securities pursuant to unlisted trading privileges but do not list securities.[54] We are exempting the listing of certain security futures products, standardized options, securities issued by unit

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50 *See, e.g.,* comment letters in response to the Reopening Release from Committee on Federal Regulation of Securities of the Section of Business Law of the American Bar Association (Jan. 24, 2022) ("ABA 2"); CCMC (Nov. 22, 2021) ("CCMC 2"); and Hunton Andrews Kurth ("Hunton").

51 In a modification from the proposal, the rule refers to a national securities association that lists securities generally, rather than the more specific reference to an association that "lists securities in an automated inter-dealer quotation system." In addition, we are simplifying the rule by not adopting proposed Rule 10D-1(b)(1)(vi), which would have specifically provided that an issuer that had been delisted for failing to comply with its recovery policy may not list its securities on an exchange, and an exchange would not be permitted to list a delisted issuer until the issuer comes into compliance with its recovery policy, because such a delisted issuer that remained out of compliance with the recovery policy would already not be permitted to list its securities on an exchange by function of 17 CFR 240.10D-1(a)(1), which requires exchanges to "prohibit the initial or continued listing of any security of an issuer that is not in compliance with the requirements of any portion of this section."

52 *See* 17 CFR 240.10D-1(a)(3).

53 Under the 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. *See* Section II.D.3..

54 Such exchanges may not list securities until their listing standards comply with the requirements of Rule 10D-1. Exchanges that do not list securities should consider updating any applicable listing standards to comply with the requirements of Rule 10D-1 or including an appropriate limitation acknowledging that they may only trade securities pursuant to unlisted trading privileges.

investment trusts, and the securities issued by certain registered investment companies from the mandated listing standards, as proposed.[55]

As the Commission stated in the Proposing Release, Section 10D does not distinguish among issuers or types of securities, and does not instruct the Commission to exempt any particular types of issuers or securities or direct the Commission to permit the exchanges to provide for such exemptions. In evaluating whether to exempt specific categories of issuers and securities, in addition to the views of commenters, we have considered whether providing exemptions from the requirements of Section 10D would be consistent with our understanding of the purpose of this statutory provision. We have also considered the incidence of restatements by different categories of issuers and whether, in light of such incidence, exempting these classes of issuers would be necessary or appropriate in the public interest and consistent with the protection of investors. Although we recognize commenters' concerns regarding application of the rule to FPIs, SRCs, and EGCs, as discussed more fully below, we have determined not to exempt these categories of issuers from the final rules.

With respect to application of the final amendments to FPIs, we note that Section 10D does not exempt FPIs. While the Commission could exercise its discretion to exempt such issuers by rule, we decline to do so. We acknowledge some of the practical concerns regarding implementation of the recovery policy raised by commenters, as discussed above; however, these concerns are not unique to FPIs and, in any event, do not in our view justify exempting such issuers from the obligation to recover incentive-based compensation that was erroneously awarded. We believe that shareholders of FPIs listed in the United States should benefit from recovery of erroneously awarded compensation in the same manner as shareholders of domestic

[55] *See* 17 CFR 240.10D-1(c)(1) through (4).

issuers. Moreover, the recovery requirements will help to encourage reliable financial reporting by listed issuers, which is as important for investors in FPIs as for other issuers. Studies have shown that foreign companies present a similar risk of restatement as other companies[56] and that U.S. issuers who are non-accelerated filers[57] accounted for approximately 53% of restatements.[58] To the extent that recovery under Rule 10D-1 would be wholly inconsistent with a foreign regulatory regime, we have included an impracticability accommodation, as discussed in Section II.C.3.b., which may alleviate some of the implementation challenges faced by FPIs.

We also do not view the application of the final amendments to FPIs listed on U.S. national exchanges as an extraterritorial application of U.S. law. The statutory language generally identifies the types of conduct that trigger the relevant requirement and, by extension, the focus of the statute for the purpose of an extraterritoriality analysis.[59] Having identified the activity regulated by the statutory provision, we can determine whether a person is engaged in conduct that the statutory provision regulates and whether this conduct occurs within the United States. The statutory focus of Section 10D is on "the listing of any security of an issuer" on a national securities exchange. The recovery policies mandated by Section 10D apply only to those foreign issuers who have chosen to access the U.S. capital markets by listing on a U.S.

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56 *See* 2020 Financial Restatements: A Twenty-Year Review, Audit Analytics (2021) ("A Twenty-Year Review") (analyzing data related to accounting restatements, including specific analysis for 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 private issuers). Foreign companies in this study included both FPIs and foreign companies filing on Form 10-K.

57 17 CFR 240.12b-2.

58 *See* A Twenty-Year Review.

59 *See Morrison v. National Australia Bank, Ltd.*, 130 S. Ct. 2869, 2884 (2010) (identifying the focus of statutory language to determine what conduct was relevant in determining whether the statute was being applied to domestic conduct).

national exchange. We thus do not view the final rules as an extraterritorial application of U.S. legal requirements.

With respect to the application of the rule to SRCs and EGCs, we note that, unlike in other provisions of the Dodd-Frank Act, Congress did not direct the Commission to consider differential treatment for certain classes of issuers, such as SRCs and EGCs.[60] Similar to our reasons for not exercising our discretion to exempt FPIs, we decline to exempt SRCs and EGCs from the final amendments. In our view, recovery of incentive-based compensation that was not earned and should not have been paid is as appropriate for smaller listed issuers as it is for larger issuers. We believe shareholders of smaller issuers should benefit from recovery of erroneously awarded compensation in the same manner as shareholders of larger issuers. Similarly, recovery encourages the preparation of reliable financial information, which may be even more important for smaller issuers and EGCs than for others because of their susceptibility to an increased likelihood of reporting an accounting error and to material weakness in internal control over financial reporting, as studies have found.[61]

We recognize, as some commenters asserted, that shareholders of controlled companies and certain private companies with listed debt may have a greater degree of control over

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[60] In contrast, Section 952 of the Dodd-Frank Act directs the Commission to take "into consideration the size of an issuer and any other relevant factors" when providing exemption authority.

[61] *See, e.g.,* Jacquelyn Gillette, Sudarshan Jayaraman, and Jerold Zimmerman *Accounting Restatements: Malfeasance and/or Optimal Incompetence?* (working paper Mar. 2017), *available at* https://pages.business.illinois.edu/accountancy/wp-content/uploads/sites/12/2017/02/YSS-2017-Gillette.pdf (finding that "larger and more profitable firms invest more in accounting resources", and that "accounting resources are negatively associated with the likelihood of a restatement"); *see also* Preeti Choudhary, Kenneth Merkley and Katherine Schipper, *Immaterial Error Corrections and Financial Reporting Reliability*, 38 CONTEMP. ACCT. RSCH. 2423 (Winter 2021) (finding that future restatements are less likely for larger firms) ("Choudhary et al"). *See also* Jeong-Bon Kim, Jay Junghun Lee, and Jong Chool Park, *Internal Control Weakness and the Asymmetrical Behavior of Selling, General, and Administrative Costs*, (37) J. ACCT. AUDITING & FIN 259-292 (2022) (finding that firms with internal control weaknesses are significantly smaller in terms of sales revenue, selling, general and administrative costs, and total assets). *See also* discussion above and Section IV.A. discussing the number of restatements for smaller issuers as compared to other issuers.

executive officers than at other companies. We further recognize that debt holders of debt-only issuers receive certain protections from the Trust Indenture Act and indenture covenants governing such debt. Recovery of erroneously awarded compensation will encourage executive officers to reduce errors requiring restatements, which could benefit potential future investors and enhance the efficiency of the market as a whole. Further, while controlling shareholders generally face fewer difficulties in directing and incentivizing executive officers, the final amendments will help minimize any gaps that remain, such as those that could exist for an issuer's minority shareholders. Although a controlling majority shareholder may owe state law duties to minority shareholders, we do not believe that investors' confidence in the accuracy of financial reporting should depend on their assessment of the likelihood of successful litigation under state law to vindicate minority shareholder rights.

We are not granting the exchanges discretion to exempt certain categories of securities from the listing standards. In reaching these conclusions, in addition to the plain language of the statute and the fundamental inequity of permitting executive officers to retain compensation they did not earn, we considered the relative burdens of compliance on different categories of issuers and types of securities. As discussed more fully in Section IV, while we recognize that the listing standards could, in certain respects, impose burdens on particular categories of issuers, there is also reason to believe that these issuers, their shareholders, and the markets in general, may derive benefits from the listing standards. The compensation recovery requirements may reduce the financial benefits to executive officers when an issuer is required to prepare an accounting restatement, and thus may increase incentives for reporting accurate financial

results.[62] Additionally, the recovery requirements may encourage issuers and their executive officers to devote more resources to the production of high-quality financial reporting. Shareholders of listed issuers will, in turn, benefit from improved financial reporting, and issuers may derive benefits in the form of reduced costs of capital. As with other categories of listed issuers, we believe that these benefits justify the costs imposed by the final amendments for specific categories of issuers, such as EGCs, SRCs, FPIs, controlled companies, and debt-only issuers.

We are adopting, as proposed, the exemptions for the listing of security futures products cleared by a registered clearing agency or a clearing agency that is exempt from the registration requirements of the Exchange Act and for standardized options issued by a registered clearing agency because the role of a clearing agency as the issuer of these securities is fundamentally different from that of other listed issuers.[63] Whereas in most cases the purchaser of a security is making an investment decision regarding the issuer of a security, the purchaser of security futures products and standardized options does not, except in the most formal sense, make an

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[62] As discussed more fully in Section IV, academic research finds that companies with strong compensation recovery provisions experience improved financial reporting, lower CEO turnover, and lower CEO compensation. *See* Michael H.R. Erkens, Ying Gan, and B. Burcin Yurtoglu, *Not all clawbacks are the same: Consequences of strong versus weak clawback provisions*, 66 J. ACCT & ECON., 291 (2018). *See also* Lillian H. Chan *et al., The Effects of Firm-Initiated Clawback Provisions on Earnings Quality and Auditor Behavior* 54 J. ACCT. & ECON. 180 (2012) (finding that after the adoption of clawback provisions, incidence of accounting restatements declines, firms' earnings response coefficients increase, and auditors are less likely to report material internal control weaknesses, charge lower audit fees, and issue audit reports with a shorter lag); Ed DeHaan, Frank Hodge, and Terry Shevlin, *Does Voluntary Adoption of a Clawback Provision Improve Financial Reporting Quality?,* 30 CONTEMP. ACCT. RSCH.1027 (2013) (finding improvements in financial reporting quality following clawback adoption, including decreases in meet-or-beat behavior and unexplained audit fees, a decrease in restatements, a significant increase in earnings response coefficients and a significant decrease in analyst forecast dispersion).

[63] *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").

investment decision regarding the clearing agency, even though the clearing agency is the issuer of those securities. 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. 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.[64] Accordingly, pursuant to our authority under Section 36 of the Exchange Act, we find that it is necessary or appropriate in the public interest, and consistent with the protection of investors, to exempt the listing of a security futures product and a standardized option from the requirements of Rule 10D-1 under the Exchange Act.[65]

Similarly, we are adopting the proposal to exempt the listing of any security issued by a listed fund on the condition that the fund has not awarded incentive-based compensation to any current or former executive officer of the fund in any of the last three fiscal years or, in the case of a fund that has been listed for less than three fiscal years, since the initial listing.[66] We make

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64 The Commission has previously recognized these fundamental differences and provided exemptions for security futures products and standardized options when it adopted the audit committee listing requirements in 17 CFR 240.10A-3 and the compensation committee listing requirements in 17 CFR 240.10C-1. *See Listing Standards for Compensation Committees*, Release No. 33-9330 (June 20, 2012) [77 FR 38422 (June 27, 2012)].

65 *See* 17 CFR 240.10D-1(c)(1) and (2).

66 *See* 17 CFR 240.10D-1(c)(4). Listed funds, unlike most other issuers, are generally externally managed and often have few, if any, employees that are compensated by the fund (*i.e.*, the issuer). Instead, listed funds 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. In order to apply the new rules to listed funds, we are amending Form N-CSR as proposed to redesignate Item 18 as Item 19 and to add a new paragraph (a)(2) to this Item (with current paragraph (a)(2) redesignated as (a)(3)) to require any listed fund that would be subject to the requirements of 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 adding new Item 18 to Form N-CSR as well as amending Item 22 of Schedule 14A of the Exchange Act to require listed funds that would be subject to Rule 10D-1 to provide information that would generally mirror the disclosure requirements of Item 402(w) of Regulation S-K.

this conditional exemption pursuant to our authority under Section 36 of the Exchange Act, because we find that it is necessary or appropriate in the public interest, and consistent with the protection of investors. The conditional exemption would permit listed funds that do not pay incentive-based compensation to avoid the burden of developing recovery policies they may never use.[67] Listed funds that have paid incentive-based compensation in that time period, however, would be subject to the rule and rule amendments and be required to implement a compensation recovery policy like other listed issuers.[68]

We are not exempting listed funds unconditionally, as two commenters suggested. The final rules are designed to reflect the structure and compensation practice of listed funds by requiring funds to implement compensation recovery policies only when they in fact award incentive-based compensation covered by Section 10D. While listed funds' financial statements may in general be less complex than those of operating companies, restatements can and do still occur. To the extent that executive officers of listed funds receive incentive-based compensation on the basis of a financial reporting measure that is restated, we believe that the policy concerns underlying the rule apply equally to listed funds, regardless of whether they were specifically mentioned in the Dodd-Frank Act's legislative history or the treatment of registered investment companies for purposes of other compensation-related disclosure requirements.

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[67] In addition, because the exemption applies to the listing of securities of registered investment companies, it would not apply to business development companies, which are a category of closed-end management investment company that is not registered under the Investment Company Act.

[68] One commenter observed that the rule would cover any incentive-based compensation paid to listed fund chief compliance officers ("CCOs") if they are within the rule's definition of an "executive officer." *See* comment letter from ICI. We agree that if a listed fund pays an executive officer incentive-based compensation within the time period specified in the final rule, then the fund would be required to implement a compensation-recovery policy. Although the commenter urged the Commission to interpret the executive officer definition to exclude a listed fund's CCO, we do not see a basis for this interpretation and the commenter did not provide one.

We also are not exempting externally managed BDCs, as one commenter suggested. Although BDCs whose advisers receive certain forms of compensation are subject to certain limitations on their ability to offer equity compensation such as options, or to establish a profit-sharing plan, the definition of incentive-based compensation in Section 10D applies to a broader range of incentive-based compensation arrangements. In addition, BDCs are generally subject to other disclosure requirements in Regulation S-K, and the final rules treat all BDCs, whether managed externally or internally, in a consistent manner.[69]

As proposed, we are exempting the listing of any security issued by a UIT because, unlike listed funds, 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, and they do not file a certified shareholder report. In addition, because the investment portfolio of a UIT is generally fixed, UITs are not actively managed. Accordingly, pursuant to our authority under Section 36 of the Exchange Act, we find that it is necessary or appropriate in the public interest, and consistent with the protection of investors, to exempt the listing of any security issued by a UIT from the requirements of Rule 10D-1 under the Exchange Act.[70]

B. Restatements

1. Restatements Triggering Application of Recovery Policy

Sections 10D(a) and 10D(b)(2) require the Commission to adopt rules directing exchanges and associations to establish listing standards that require issuers to develop and

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[69] A commenter suggested that the Commission had previously exempted externally managed BDCs from pay ratio disclosure requirements adopted in 2015. *See* comment letter of Clifford Chance *et al*. The rule did not provide an exemption for externally managed BDCs. Instead, the Commission observed that as a practical matter no externally managed BDCs would be subject to it. *See Pay Ratio Disclosure*, Release No. 33-9877 (Aug. 5, 2015) [80 FR 50103 (Aug. 18, 2015)] at n.90 ("Business development companies will be treated in the same manner as issuers other than registered investment companies and therefore will be subject to the pay ratio disclosure requirement").

[70] *See* 17 CFR 240.10D-1(c)(3) and (4).

implement 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 …."[71]

a. Proposed Amendments

The Commission proposed to require that issuers adopt and comply with a written policy providing that in the event the issuer is required to prepare a restatement[72] to correct an error[73]

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71 *See* Senate Report at 135.

72 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* Financial Accounting Standards Board Accounting Standards Codification Topic 250, *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* International Accounting Standard 8, *Accounting Policies, Changes in Accounting Estimates and Errors* ("IAS 8"), paragraph 5.

73 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, paragraph 5.

that is material[74] to previously issued financial statements,[75] the obligation to prepare the restatement would trigger application of the compensation recovery policy. In connection with this proposed trigger, the Commission proposed to define an "accounting restatement"[76] and specifically noted 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.[77]

After the Commission issued the Proposing Release, some commentators expressed concerns that some issuers may not be making appropriate materiality determinations for errors identified[78] and may be seeking to avoid recovery under their compensation recovery policies.[79] In the Reopening Release, the Commission stated that it was considering whether to interpret the phrase "an accounting restatement due to material noncompliance" to include all required restatements made to correct an error in previously issued financial statements and sought public

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74 The Commission did not propose any additional clarification about when an error 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 and has received extensive and comprehensive judicial and regulatory attention. *See, e.g., TSC Industries, Inc. v. Northway*, 426 U.S. 438 (1976); *Basic v. Levinson*, 485 U.S. 224 (1988).

75 When we refer to financial statements, we mean the statement of financial position (balance sheet), statement of comprehensive income, statement of cash flows, statement of stockholders' equity, related schedules, 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 17 CFR 210. 6-10, financial highlights, and accompanying footnotes, as required by Commission regulations.

76 The Commission proposed to define the term 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."

77 *See* Section II.B.1 of the Proposing Release.

78 *See* Choudhary *et al., supra* note 61.

79 *See, e.g.,* Jean Eaglesham, *Shh! Companies Are Fixing Accounting Errors Quietly*, WALL ST. J. (Dec. 5, 2019), *available at* https://www.wsj.com/articles/shh-companies-are-fixing-accounting-errors-quietly-11575541981. *See also* Rachel Thompson, *Reporting Misstatements as Revisions: An Evaluation of Managers' Use of Materiality Discretion* (working paper Sept. 17, 2021) *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3450828 (retrieved from SSRN Elsevier database).

feedback on such an interpretation. In particular, the Commission requested comment on whether to provide that recovery is required with respect to both (1) restatements that correct errors that are material to previously issued financial statements (commonly referred to as "Big R" restatements), and (2) restatements that correct errors that are not material to previously issued financial statements, but would result in a material misstatement if (a) the errors were left uncorrected in the current report or (b) the error correction was recognized in the current period (commonly referred to as "little r" restatements).[80] A "little r" restatement differs from a "Big R" restatement primarily in the reason for the error correction (as noted above), the form and timing of reporting, and the disclosure required. For example, a "Big R" restatement requires the issuer to file an Item 4.02 Form 8-K and to amend its filings promptly to restate the previously issued financial statements.[81] In contrast, a "little r" restatement generally does not trigger an Item 4.02 Form 8-K, and an issuer may make any corrections "the next time the registrant files the prior year financial statements."[82] In connection with the Second Reopening Release, the Commission provided further opportunity to analyze and comment upon a memorandum prepared by Commission staff containing additional analysis and data on compensation recovery policies and accounting restatements.[83]

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80 *See* Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (Sept. 13, 2006). Studies cited and data included in this release on "little r" restatement frequency may define "little r" restatements differently than the definition used herein and are generally based on the total number of revisions to previously issued financial statements where the issuer did not file an Item 4.02 Form 8-K.

81 An Item 4.02 Form 8-K is required to be filed when an issuer concludes that any of its previously issued financial statements should no longer be relied upon because of an error in such financial statements. It is due within four business days after the conclusion.

82 See *supra* note 80.

83 In the 2022 staff memorandum, the staff refers to "little r" restatements as restatements that correct errors that would only result in a material misstatement if the errors were left uncorrected in the current report or the error correction was recognized in the current period. This reference has the same meaning as the description of "little r" restatements in this release.

b. Comments

We received a range of comments on the proposals regarding restatements triggering application of the compensation recovery policy. In response to the Proposing Release, some commenters expressed support for the proposed use of the concept of a "material error" as the standard for the recovery trigger.[84] Some commenters suggested that the materiality standard was vague, or thought examples would be helpful.[85] Other commenters recommended that the Commission expressly provide that a restatement to correct immaterial errors would not trigger a compensation recovery,[86] or sought additional guidance for aggregating immaterial error corrections.[87] Some commenters recommended that recovery should not be limited to restatements for errors that were material to the previously issued financial restatements,[88] or recommended revisions to the proposed definition of "accounting restatement."[89] Other

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84 *See* comment letters from Business Roundtable (Sept. 14, 2015) ("BRT 1"); Better Markets 1; Center On Executive Compensation (Sept. 14, 2015) ("CEC 1"); CFA Institute 1; Ernst & Young LLP ("EY") (Sept. 15, 2015); NACD; PricewaterhouseCoopers LLP ("PWC"); SCG 1; and SBA.

85 *See* comment letters from CalPERS 1; Exxon/Mobil Corporation ("Exxon") (suggesting that recovery should only be triggered by a restatement that "significantly altered the total mix of information available"); International Bancshares Corporation ("IBC") (suggesting that recovery should only be triggered by a restatement if there is a substantial likelihood a reasonable investor would consider the restatement as important in deciding how to vote); Japanese Bankers; National Association of Manufacturers ("NAM") (suggesting ambiguity could result in great variation among issuers in which restatements should trigger recovery); and SBA.

86 *See* comment letters from CCMC 1; Chevron Corporation ("Chevron"); EY; and SCG 1. *See also* comment letter from PWC (suggesting that inclusion of the word "material" clarifies that the listing standard would not apply to restatements that reflect the correction of immaterial errors).

87 *See* comment letters from ABA 1; Chevron; Corporate Governance Coalition for Investor Value ("Coalition"); Davis Polk 1; FSR; and IBC.

88 *See* comment letters from AFL-CIO (Sept. 14, 2015) (expressing concern regarding "revision restatements" that would allow an issuer to avoid the application of the proposed compensation recovery provisions); As You Sow (Sept. 15, 2015) ("As You Sow 1"); CII 1; CalPERS 1; and SBA. *But see* comment letter from ABA 1 (noting "that the analysis of an error's materiality takes into account the error's impact on executive compensation").

89 *See* comment letters from Chevron and SCG 1 (recommending that the definition include a specific reference to GAAP) and from ABA 1 (recommending that the definition refer to the applicable accounting standards). *See also* comment letter from PWC (noting that the proposed definition permits the listing standard to be applied regardless of the accounting framework a listed issuer follows).

commenters suggested that recovery should be triggered when *any* revision to previously issued financial statements occurred.[90] Other commenters, noting a decline in the number of formal accounting restatements, recommended that the Commission expand the scope of the rulemaking beyond implementation of Section 10D to require compensation recovery policies to address instances of misconduct by executive officers that do not result in a financial restatement.[91]

In response to the Reopening Release, we received a similar range of comments relating to the recovery trigger and the meaning of "an accounting restatement due to material noncompliance."[92] A number of commenters supported the standard set forth in the Proposing Release that would apply recovery policies only when a restatement is required to correct errors that are material to previously issued financial statements and triggers disclosure under Item 4.02(a) of Form 8-K.[93] These commenters further contended that an "accounting restatement due to material noncompliance" should not include "little r" restatements.[94] Other commenters

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90 *See, e.g.,* comment letters from As You Sow 1; CII 1; and CalPERS 1.

91 *See* comment letters from AFL-CIO; AFR 1; Plamen Kovachev ("Kovachev") (recommending the rule include ethical misconduct triggers to more closely align the rule with executives' fiduciary duties); Rutkowski 1; and UAW Retiree Medical Benefits Trust, *et al*. ("UAW, *et al*.").

92 One commenter on the Reopening Release suggested "it would be easier and more streamlined for issuers to rely on existing guidance, literature, and definitions concerning accounting errors rather than define the terms 'accounting restatement' and 'material noncompliance.'" *See* comment letter in response to the Reopening Release from ABA 2.

93 *See, e.g.,* comment letters in response to the Reopening Release from Davis Polk 3 (stating that "immaterial errors should not trigger clawback policies" and cautioning against creating a new materiality standard for disclosure of financial restatements solely for Rule 10D-1 purposes); Hunton; McGuireWoods, LLP and Brownstein Hyatt Farber Schreck LLP ("McGuireWoods") (recommending that the Commission define "material error" as occurring when the issuer is required, by applicable accounting standards, to issue restated financial statements to correct one or more errors that are "material" to previously issued financial statements); S&C (contending that immaterial error corrections to the current period—commonly referred to as out-of-period adjustments—should not be included because they are not restatements or "due to material noncompliance") (Nov. 16, 2021) ("S&C 2"); and SCG (Nov. 29, 2021) ("SCG 3").

94 *See, e.g.,* comment letters in response to the Reopening Release from Davis Polk 3 (contending that Proposing Release facilitates the purpose of the recovery rule in being triggered on the basis of "meaningful errors" and that "little r" restatements do not meet this standard and would create costs due to the uncertainty of the standard); Hunton (suggesting that "little r" restatements are immaterial to investors and should not serve as a recovery policy trigger); McGuireWoods (suggesting that Section 10D intended that not all restatements should

supported interpreting what it means to be required to prepare an accounting restatement due to material noncompliance in the manner described in the Reopening Release.[95] Some of these commenters noted research suggesting that issuers may be deeming revisions to be immaterial even though the revisions meet at least one of the indicators of materiality described in Staff Accounting Bulletin No. 99.[96] Some of these commenters additionally suggested that the increasing prevalence of revisions may stem from management seeking to avoid restatements that would trigger an Item 4.02 Form 8-K filing or the application of a compensation recovery policy provision.[97] Some commenters further recommended expanding the recovery policy triggers.[98]

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trigger recovery and, in particular, that immaterial restatements should be excluded from recovery); and SCG 3. As discussed below, we disagree with how a number of these commenters characterize "little r" restatements.

95 *See, e.g.,* comment letters in response to the Reopening Release from Better Markets (Nov. 22, 2021) ("Better Markets 2") (recommending including a definition in the final rule, such as one defining an accounting restatement as either a revision restatement or a re-issuance restatement, to avoid unintended, inconsistent interpretations, and other enforcement challenges that could result from reliance on guidance); CFA Institute (Nov. 22, 2021) ("CFA Institute 2") (suggesting a broad interpretation may serve to mitigate the perception of misaligned motivations); Council of Institutional Investors (Nov. 18, 2021) ("CII 3") (suggesting that Section 10D was not intended to narrowly limit the required recovery policy to exclude "little r" restatements); International Corporate Governance Network ("ICGN"); Occupy the SEC ("Occupy"); Ohio Public Employees Retirement System (Nov. 22, 2021) ("OPERS 2") (recommending that the Commission clarify "that its definition of 'accounting restatement' includes all required restatements made to correct an error in previously issued financial statements, regardless of whether they are formal restatements or revisions"); and Public Citizen 2. *See also* comment letters in response to the Second Reopening Release from Americans for Financial Reform (July 6, 2022) ("AFR 2") (noting studies finding that "little r" restatements have been issued in lieu of "Big R" restatements to avoid compensation recovery provisions); and Council of Institutional Investors (June 24, 2022).

96 *See, e.g.,* comment letters in response to the Reopening Release from CFA Institute 2 (further suggesting that lack of transparency in the issuer's materiality assessment and the reason for the method of correction may be contributing factors); and OPERS 2.

97 *See, e.g.,* comment letters in response to the Reopening Release from Better Markets 2; and OPERS 2.

98 *See, e.g.,* comment letters in response to the Reopening Release from New York City Retirement Systems ("NYCRS") (recommending recouping compensation from executives responsible for detrimental conduct causing significant financial or reputational harm); and New York State Common Retirement Fund ("NYSCRF") (recommending recouping compensation awarded to executives during periods of fraudulent activity, inadequate oversight, misbehavior, including discrimination and harassment of any kind, or gross negligence, which impacted or is reasonably expected to impact financial results or cause reputational harm).

A few commenters supported a requirement for an issuer to disclose its evaluation that errors are immaterial,[99] while some other commenters opposed requiring this disclosure.[100] Another stated that "involvement of the independent auditors in evaluating management's materiality analysis and concurring (through the audit opinion) with management's conclusion, with oversight from the company's audit committee, provides sufficient protection of investor interests that material errors do not go uncorrected by a company trying to avoid the clawback of incentive compensation."[101]

c. Final Amendments

After considering comments received on the Proposing Release and reopening releases, in a change from the proposal, we are adopting rules to require listed issuers to adopt and comply with a written compensation recovery policy that will be triggered in the event the issuer is required to prepare an accounting restatement that corrects an error in previously issued financial statements that is material to the previously issued financial statements, or that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period.[102] While the proposed rules focused on restatements for errors that are material to the previously issued financial statements, after further consideration and input from commenters, the final rules reflect a broader construction of the phrase "an accounting

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[99] *See, e.g.,* comment letters from Better Markets 1; CalPERS 1; and CFA Institute 1. *See also* comment letter from CFA Institute 1 (noting that because of the inherent estimates, judgements, and complexity involved, issuers should disclose their evaluations, the process and assumptions used to determine whether the error(s) in question were material or immaterial, and why they decided the matter in this way and suggesting that thorough disclosure provides investors enough information to understand the material facts and the reasoning behind such determination, and thereby helps them to make appropriate decisions about the board's actions); and ICGN.

[100] *See, e.g.,* comment letters from BRT 1 (suggesting it is a tenet of the Federal securities laws that disclosure of immaterial information is not required); EY; NACD; and SCG 1.

[101] *See* comment letter from EY.

[102] *See* 17 CFR 240.10D-1(b)(1) ("Rule 10D-1(b)(1)").

restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws" based upon the fact that both types of restatements are caused by *material* misstatements that either already exist or would exist in the current period.

In our view, the statutory language of Section 10D—"an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws"—can appropriately be read to encompass both "Big R" and "little r" restatements. First, as a threshold matter, we disagree with those commenters who stated that "little r" restatements are not accounting restatements. We note that both are considered "accounting restatements" under U.S. GAAP and IFRS[103] because both result in revisions of previously issued financial statements for a correction of an error in those financial statements. In contrast, as noted by one commenter, sometimes the correction of an error is recorded instead in the current period financial statements – commonly referred to as an out-of-period adjustment – when the error is immaterial to the previously issued financial statements, and the correction of the error is also immaterial to the current period.[104] We agree with that commenter that an out-of-period adjustment should not trigger a compensation recovery analysis under the final rules, because it is not an "accounting restatement."[105]

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[103] *See supra* note 72.

[104] *See* comment letter from S&C 2.

[105] *See supra* note 93. In response to commenters who requested clarification about the statement in the Proposing Release 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," we do not think this is necessary. *See supra* note 87. Staff guidance on materiality is already available which specifically addresses the aggregation of misstatements that individually do not cause the financial statements taken as a whole to be materially misstated. *See infra* note 108. Furthermore, the scope of the final amendments includes "little r" restatements, which are sometimes required due to the cumulative effects of an error over multiple reporting periods. *See* more detailed discussion below.

Second, both types of restatements address material noncompliance of the issuer with financial reporting requirements. In the case of a "Big R" restatement, the material noncompliance results from an error that was material to previously issued financial statements. In the case of a "little r" restatement, the material noncompliance results from an error that is material to the current period financial statements if left uncorrected or if the correction were recorded only in the current period.[106] Due to the materiality of the impact the error would have on the current period, the previously issued financial statements must be revised to correct it even though the error may not have been material to those financial statements. We note that the plain language of Section 10D does not limit the concept of "an accounting restatement due to material noncompliance" to effects on previously issued financial statements, and thus the final rules require compensation recovery analysis for both "Big R" and "little r" restatements.

We also disagree with those commenters who asserted that including "little r" restatements would make it difficult to comply with the rule. Issuers are already required to perform a materiality analysis on each error that is identified in order to determine how to account for and report the correction of that error. Thus, issuers will have already performed the analysis necessary to identify these additional accounting restatements. Furthermore, the final

[106] We note that certain errors may compound over time. While the initial error amount may not have been material to previously issued financial statements, it may become material due to its cumulative effect over multiple reporting periods. A material adjustment to the current period that relates to an error from previously issued financial statements would cause the current period financial statements to be materially misstated. An example of such error is an improper expense accrual (such as an overstated liability) that has built up over five years at $20 per year. Upon identification of the error in year five, the issuer evaluated the misstatement as being immaterial to the financial statements in years one through four. To correct the overstated liability in year five a $100 credit to the statement of comprehensive income would be necessary; however, $80 of it would relate to the previously issued financial statements for years one through four. During the preparation of its annual financial statements for year five, the issuer determines that, although a $20 annual misstatement of expense would not be material, the adjustment to correct the $80 cumulative error from previously issued financial statements would be material to comprehensive income for year five. Accordingly, the issuer must correct the financial statements for years one through four.

rules reduce uncertainty regarding their scope by expressly identifying the types of restatements that are required to be included within an issuer's recovery policy.

In addition to being clear and consistent with applicable accounting literature, guidance, and the plain language of Section 10D, this construction of the statutory language addresses concerns that issuers could manipulate materiality and restatement determinations to avoid application of the compensation recovery policy.[107] In this regard, we note that Commission staff has provided guidance to assist issuers in making materiality determinations. The staff guidance emphasizes that an issuer's materiality evaluation of an identified unadjusted error should consider the effects of the identified unadjusted error on the applicable financial statements and related footnotes, and evaluate quantitative and qualitative factors.[108] Registrants, auditors, and audit committees should already be aware of the need to assess carefully whether an error is material by applying a well-reasoned, holistic, objective approach from a reasonable investor's perspective based on the total mix of information. Further, whether the misstatement has the effect of increasing management's compensation, for example, by

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[107] We note evidence supporting the materiality manipulation concern. *See*, *e.g.,* Brian Hogan and Gregory A. Jonas, *The association between executive pay structure and the transparency of restatement disclosures*, ACCT. HORIZONS (Sept. 2016) (finding that CFO pay structure is correlated with the transparency of restatement disclosure ("Big R" vs. "little r")). *See also* Thompson, *supra* note 69 (finding that issuers with compensation recovery provisions are more likely to report misstatements as "little r" restatements instead of "Big R" restatements).

[108] *See* Staff Accounting Bulletin No. 99, *Materiality* (Aug. 12, 1999) and Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (Sept. 13, 2006). (This guidance and any other staff statement cited in this release is not a rule, regulation, or statement of the Commission and the Commission has neither approved nor disapproved its content. This guidance, like all staff statements, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person.) We note that Commission staff have observed that some materiality analyses appear to be biased toward supporting an outcome that an error is not material to previously issued financial statements. *See id*. Relatedly, it has been reported that, while the total number of accounting restatements by issuers declined each year from 2013 to 2020, the percentage of "little r" restatements increased to approximately 76% of restatements in 2020. *See* Audit Analytics, *2020 Financial Restatements: A Twenty-Year Review* (November 2021).

satisfying requirements for the award of bonuses or other forms of incentive compensation, is a qualitative factor that should be considered when making a materiality determination

Requiring recovery analysis for both "Big R" and "little r" accounting restatements does not eliminate the risk that an issuer could avoid a recovery obligation by manipulating its materiality analysis of an error.[109] While this is an inherent risk, we note the involvement of an independent auditor in evaluating management's materiality analyses, with the oversight of the audit committee, protects investor interests by helping ensure that material errors do not go uncorrected by an issuer seeking to avoid the recovery of erroneously awarded compensation. Furthermore, we note the potential serious consequences, including but not limited to Commission enforcement action and private litigation, of mischaracterizing material accounting errors as immaterial.

For similar reasons, we are not adopting a requirement for an issuer to disclose the materiality analysis of an error when the error is determined to be immaterial, as recommended by some commenters. Inclusion of "little r" restatements in the scope of restatements triggering recovery, the involvement of independent auditors and oversight of audit committees, and the serious potential consequences of deliberate mischaracterizations of accounting errors, should mitigate the risk that some errors will be incorrectly determined to be immaterial. Further, many assessments of materiality are complex and highly sensitive to particular facts and circumstances. Requiring issuers to disclose sufficient information to make these assessments meaningful to investors would likely entail lengthy disclosures that may be of limited use for investors. Instead, we are adopting a disclosure requirement, discussed in Section II.D., for

[109] This could occur if an issuer were to inappropriately conclude that an identified error was not material to its previously issued financial statements or the current period.

issuers to clearly identify on the cover page of their annual reports when the financial statement periods presented contain restatements, which should provide additional transparency regarding such restatements.

In a change from the proposal, Rule 10D-1 will not provide separate definitions of "accounting restatement" or "material noncompliance" as proposed. Existing accounting standards and guidance already set out the meaning of those terms.[110] This rule is not intended to affect that guidance. While we acknowledge that a number of commenters supported the proposed definitions of "accounting restatement" and "material noncompliance," in light of the modifications discussed above, we agree with the commenter that suggested that it will be easier for issuers to look to existing guidance, literature, and definitions when assessing accounting errors[111] and that such an approach will help ensure that those standards are consistently applied both across different issuers and over time.

As indicated in the Proposing Release, we understand that under current accounting standards the following types of changes to an issuer's financial statements do not represent error corrections, and therefore would likewise not trigger application of the issuer's compensation recovery policy under the listing standards:

- Retrospective application of a change in accounting principle;[112]

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[110] Rule 10D-1 clarifies the meaning of an "accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws."

[111] *See* comment letter in response to the Reopening Release from ABA 2.

[112] 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.

- Retrospective revision to reportable segment information due to a change in the structure of an issuer's internal organization;[113]
- Retrospective reclassification due to a discontinued operation;[114]
- Retrospective application of a change in reporting entity, such as from a reorganization of entities under common control;[115]
- Retrospective adjustment to provisional amounts in connection with a prior business combination (IFRS filers only);[116] and
- Retrospective revision for stock splits, reverse stock splits, stock dividends or other changes in capital structure.

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

Section 10D(b)(2) requires recovery of erroneously awarded 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 an issuer is "required to prepare an accounting restatement" for purposes of this provision.

a. Proposed Amendments

The Commission proposed 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

[113] 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.

[114] *See* ASC Topic 205-20. IFRS 5 has similar guidance.

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

[116] *See* IFRS 3, paragraph 45.

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.

A note to the proposed rule indicated 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 would be predicated on if or when a Form 8-K was filed. In the Reopening Release, the Commission solicited further comment as to whether to remove the "reasonably should have concluded" language in light of concerns that the language adds uncertainty to the determination.

b. Comments

We received a range of comments on the proposed specification of the date the issuer is required to prepare an accounting restatement (referred to in this release as the "trigger date"). Some commenters supported including "reasonably should have concluded" as an objective standard that provides certainty and prevents manipulation or the potential for evasion,[117] while others expressed concern that use of "reasonably should have concluded" could introduce elements of uncertainty and subjectivity into the determination.[118] Some commenters recommended a bright-line standard involving a single date, such as the date of the Item 4.02(a)

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[117] *See* comment letters from Better Markets 1; and Compensia. Some commenters specifically supported using the earlier to occur of the alternative dates, as proposed. *See, e.g.,* letters from CalPERS 1; CII 1; and CFA Institute 1.

[118] *See, e.g.,* comment letters from ABA 1; BRT 1; CEC 1; Exxon; and SCG 1. Some of these commenters further suggested that the language could invite disputes or lead to litigation. *See, e.g.,* comment letters from Exxon; and SCG 1.

Form 8-K filing.[119] Other commenters recommended including as a trigger the filing of an Item 4.02(b) Form 8-K disclosing that independent accountants have advised the issuer that the financial statements can no longer be relied upon.[120] Some commenters, however, did not believe that receipt of such a notification from the auditor should be conclusive.[121]

Some commenters expressed the view that existing legal requirements provide sufficient deterrents against intentionally delaying issuance of a restatement.[122] Other commenters expressed concerns about the potential for delay,[123] and one suggested the proposed "reasonably should have concluded" language would discourage issuers from improperly delaying filing a restatement to avoid recovery.[124]

In response to the Reopening Release, a number of commenters expressed support for the inclusion of "reasonably should have concluded" language in the proposed rule because in their view it would create a more objective standard and appropriately limit board discretion.[125] In

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119 *See, e.g.,* comment letters from Davis Polk 1; Mercer; and NACD. *See also* comment letters from Exxon (recommending the actual issuance of a restatement); and Public Citizen 1 (recommending the date the erroneous financial statement is filed).

120 *See* comment letters from CFA Institute 1; and EY.

121 *See* comment letters from ABA 1; and SCG 1.

122 *See, e.g.,* comment letters from ABA 1 (noting that other existing laws, including the certification requirements and anti-fraud provisions of the Exchange Act as well as applicable corporate law, provide the appropriate incentives to make timely financial reporting determinations in connection with Commission filings); and Exxon (noting Commission and private litigation liabilities likely to accrue while a material error in an issuer's financial reporting remains uncorrected, the personal certification requirements applicable to the principal executive and financial officers, and the risk that an issuer's independent auditors will refuse to give an opinion on financial statements containing an uncorrected material error).

123 *See* comment letters from Public Citizen 1; and CFA Institute 1 (noting that considerable time can pass between the time an error is detected and the time a court or regulator requires the issuer to take action).

124 *See* comment letter from CII 1.

125 *See, e.g.,* comment letters in response to the Reopening Release from Better Markets 2 (suggesting the "reasonably should have concluded" language imposes an enforceable obligation on the issuer and reduces the likelihood of litigation by inducing issuers to act prudently to avoid the risk); CFA Institute 2 (suggesting the language would mitigate concerns about internal investigations taking longer than necessary, unreasonable delays in reaching a conclusion, or misalignment of executives' incentives impacting the timeliness or accuracy of the financial reporting); and ICGN. *See also* comment letters in response to the Reopening Release from Eileen Morrell; Public Citizen 2; Occupy; and OPERS 2 (supporting the use of the "reasonably should have

contrast, other commenters supported using the date the issuer's board of directors (or 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 that the issuer's previously issued financial statements contain a material error." Some of these commenters expressed concern about uncertainty or ambiguity associated with the "reasonably should have concluded" determination.[126]

Some commenters on the proposal additionally sought guidance as to the types of facts that would support a finding that the issuer reasonably should have concluded that its previously issued financial statements contain a material error.[127] Some commenters also sought clarification regarding when a regulator or other legally authorized body directs an issuer to restate its previously issued financial statements to correct a material error.[128]

c. Final Amendments

concluded" language); and comment letter in response to the Second Reopening Release from AFR 2 (suggesting that the "reasonably should have concluded" language discourages issuers from delaying actions necessary to fix erroneous financial statements).

[126] *See, e.g.,* comment letters in response to the Reopening Release from ABA 2 (suggesting the "reasonably should have concluded" language would add subjectivity by using a triggering event that differs from Form 8-K and would be open to second-guessing and litigation); CEC (Nov. 17, 2021) ("CEC 2") (suggesting the language creates excessive uncertainty and excessive legal risk based on the board's view of when the look back period should commence versus the view of an impacted shareholder or an executive who disputes that timing); Davis Polk 3; and McGuireWoods (suggesting the standard would be ambiguous and overly broad and noting that Item 4.02 of Form 8-K relies on when the board concludes a restatement is required). *See also* comment letter in response to the Reopening Release from SCG 1 (noting that knowingly, recklessly, or negligently misreporting false or misleading financial information already subjects the issuer to liability).

[127] *See* comment letters from CEC 1; Compensia; and SCG 1 (seeking clarification that a restatement by an issuer's peer group member does not trigger recovery when an issuer's incentive-based compensation is based on performance relative to the peer group).

[128] *See* comment letter from EY (suggesting that it may be unclear whether a request for a restatement from a regulator would be a trigger, given the lack of finality of the determination). *See also* comment letters from CEC 1 (recommending that the date not be established until a court order is final and non-appealable); and SCG 1 (recommending that the date of the initial court or agency restatement order should be designated as the starting point of the three-year look-back period, but only after the order is final and non-appealable).

After considering the comments, we are adopting the rules substantially[129] as proposed to provide that under the listing standards 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 is required to prepare an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws as described in Rule 10D-1(b)(1); or
- The date a court, regulator or other legally authorized body directs the issuer to prepare an accounting restatement.[130]

We believe the final rule provides reasonable certainty for issuers, shareholders, and exchanges while minimizing incentives for issuers to delay their restatement conclusions. While we acknowledge some commenters' assertion that a bright-line or single-date standard might be easier to apply, we continue to have concerns that such an approach would not address the potential for delay of a restatement determination in order to manipulate the recovery date.

As noted in the Proposing Release,[131] using the date the erroneous financial statements were filed as the triggering date would be inconsistent with the three-year look-back period

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[129] In a nonsubstantive change from the proposal, we have incorporated the standard for the date the issuer is required to prepare an accounting restatement into 17 CFR 240.10D-1(a)(1)(ii) rather than separately defining the term "date on which an issuer is required to prepare an accounting restatement" in paragraph (c) as proposed.

[130] *See* 17 CFR 240.10D-1(b)(1)(ii) ("Rule 10D-1(b)(1)(ii)").

[131] *See* Proposing Release at Section II.B.2 ("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.").

because if the date of filing of the erroneous financial statements were used, recovery would not apply to any incentive-based compensation received after that date, even when the amount was affected by the erroneous financial statements. As a result, we disagree with the suggestion that the look-back period should be triggered by the date the issuer files the accounting restatement. The issuer will necessarily determine that it is "required to prepare" a restatement on or before the day it files the restatement. We have not adopted this suggestion because it would allow an issuer to delay the recovery period, and potentially reduce the amount of compensation subject to recovery, by delaying the filing of a restatement it had already determined it was required to prepare.

Rather, we agree with the commenters that indicated that the timing standard we are adopting is sufficiently certain and appropriately limits board discretion. The standard promotes compliance with the rule by making evasion of the application of a recovery policy more difficult.[132] The "reasonably should have concluded" concept reduces the incentive for an issuer to delay the investigation of a known error and the decision that a restatement is necessary, because the delayed decision date would not determine the beginning of the recovery period. We recognize that, as some commenters indicated, establishing the trigger date as the date that the issuer's board concludes, or reasonably should have concluded, that the issuer is required to prepare an accounting restatement creates some risk that the board's conclusions will be subject to litigation. We believe this risk is acceptable in light of the benefit of deterring issuers from manipulating the timing of their conclusions to avoid or delay a recovery obligation. In order to

[132] Rule 10D-1(b)(1)(ii) is being established specifically for purposes of determining the relevant recovery period under Rule 10D-1. The "reasonably should have concluded" language applies only with respect to the determination of the three-year look-back timing for purposes of compensation recovery. It does not apply with respect to a conclusion under applicable accounting rules and standards as to whether there is an error that requires a restatement.

trigger application of the recovery policy, an issuer merely needs to have concluded that it is required to prepare an accounting restatement, which may occur before the precise amount of the error has been determined.[133] We further note that applying a reasonableness standard to the determination of the three-year look-back supports an exchange's ability to enforce the recovery provision by providing the exchange a standard by which to review an issuer's conclusion.

To the extent that an issuer is required to file an Item 4.02(a) Form 8-K, the conclusion that it is required to prepare an accounting restatement is expected to coincide with the occurrence of the event disclosed in the Form 8-K.[134] In addition, in applying a reasonableness standard to the determination of a three-year look-back period, while not dispositive, one factor that an issuer would have to consider carefully would be any notice that it may receive from its independent auditor that previously issued financial statements contain a material error.[135]

While we anticipate that most issuers will make their determination regarding the three-year look-back trigger based on the standard in 17 CFR 240.10D-1(b)(1)(ii)(A), some issuers may not conclude they are required to prepare an accounting restatement and instead may choose

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[133] We disagree with commenters that asserted that the reasonableness standard increases uncertainty or ambiguity. While we acknowledge that the standard is not a fixed date in time, it is intended to allow an exchange to assess, based on the facts available to the issuer, the point at which a reasonable person would have concluded that an accounting restatement is required. Contrary to a subjective determination, this standard provides for an objective assessment based on the facts available as to the determination of the timing of the lookback.

[134] In a modification from the proposal, we are no longer including a note indicating that the date generally is expected to coincide with the occurrence of the event described in Item 4.02(a) of Exchange Act Form 8-K because we are expanding the circumstances that would trigger the analysis to include "little r" restatements which generally do not require reporting on a Form 8-K.

[135] We are not, however, adopting the suggestion of some commenters that the filing of an Item 4.02(b) Form 8-K disclosing that independent accountants have advised the issuer that the financial statements can no longer be relied upon be included as a trigger. *See supra* note 120. As noted by another commenter, such a date may not be conclusive. *See* comment letter from ABA 1. However, 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, at the latest, when the listed issuer determines to restate its financial statements, even if it subsequently neglects to file an Item 4.02(a) Form 8-K to report that decision.

to contest whether an accounting restatement is required. While we expect these occurrences to be rare, 17 CFR 240.10D-1(b)(1)(ii)(B) ("Rule 10D-1(b)(1)(ii)(B)") clarifies that in these circumstances, the trigger date will be *no later than* the date a court, regulator, or other legally authorized body directs the issuer to prepare an accounting restatement. In the event that such date is different than the date an issuer reasonably should have concluded that an accounting restatement is required, Rule 10D-1(b)(1)(ii) mandates that the trigger date be the earlier date. In response to questions raised by a commenter, we are clarifying that for purposes of Rule 10D-1(b)(1)(ii)(B), the date of the initial court order or agency action would be the trigger date for the three-year look-back period, but that the determination and application of the recovery policy would occur only after the order is final and non-appealable.

Incorporating the triggering events into the rule rather than leaving the determination solely to the issuer will 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, is triggered for purposes of the listing standards. In this regard, we note that the rule also states that an issuer's obligation to recover erroneously awarded compensation is not dependent on if or when the restated financial statements are filed with the Commission.[136]

C. Application of Recovery Policy

1. Executive Officers Subject to Recovery Policy

Section 10D identifies the class of persons and the time frame during which that class of persons is subject to recovery of erroneously awarded incentive-based compensation. Specifically, 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 erroneously

[136] *See* 17 CFR 240.10D-1(b)(1)(i)(B) ("Rule 10D-1(b)(1)(i)(B)").

awarded compensation from "any current or former executive officer of the issuer who received incentive-based compensation" during the three-year look back period.[137]

a. Proposed Amendments

The Commission proposed to include in the listing standards a definition of "executive officer" modeled on the definition of "officer" in 17 CFR 240.16a-1(f) ("Rule 16a-1(f)"). For purposes of Section 10D, the proposed definition of "executive officer" included 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. The proposed definition expressly included the principal financial officer and the principal accounting officer (or if there is no such accounting officer, the controller), reflecting the view that their responsibility for financial information justifies their inclusion in the definition of "executive officer" for this purpose. As proposed, 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.[138]

The Commission additionally proposed that the rules 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. This would include incentive-based

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[137] Section 10D does not define "executive officer" for purposes of the recovery policy. 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.

[138] The proposed definition also contained 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 significant and that persons identified as "executive officers" pursuant to 17 CFR 229.401(b) are presumed to be executive officers for purposes of the proposed rule.

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.[139]

b. Comments

Commenters provided varying recommendations on the appropriate definition of "executive officer." Some commenters expressly supported the proposed definition,[140] and one recommended expanding the definition.[141] Other commenters suggested that the proposed definition was too broad.[142] Some of these commenters contended that Section 10D does not require the breadth of the proposed definition,[143] and some further recommended various other limits on covered executive officers.[144] In contrast, some commenters noted that a narrower

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[139] 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.

[140] *See, e.g.,* comment letters from AFL-CIO; AFR 1; As You Sow 1; Better Markets 1; CEC 1; CFA Institute 1; CII 1; OPERS (Sept. 14, 2015) ("OPERS 1") (supporting the focus on policy-making functions); Public Citizen 1; Rutkowski 1; and UAW, *et al*.

[141] *See* comment letter from Better Markets 1 (recommending including the principal legal officer, the chief compliance officer, and the chief information officer). *But see* comment letter from CEC 1 (suggesting that expanding the pool of executives beyond Section 16 officers would go beyond Congress' intended purpose).

[142] *See, e.g.,* comment letters from ABA 1; American Vanguard Corporation ("American Vanguard"); CCMC 1; Chevron; Coalition; Compensia; Duane; FedEx Corporation (Sept. 14, 2015) ("FedEx 1"); Fried; Hay Group, Inc. ("Hay Group"); IBC; Japanese Bankers; Kovachev; NAM; Pay Governance LLC ("Pay Governance"); S&C 1; SCG 1; Steven Hall & Partners ("SH&P"); and WorldatWork ("WAW"). *See also* comment letters in response to the Reopening Release recommending limiting the term to executives who had a meaningful role or responsibility over the issuer's financial reporting from ABA 2; CCMC 2; McGuireWoods; and SCG (Nov. 3, 2021) ("SCG 2").

[143] *See, e.g.,* comment letters from CCMC 1; Chevron; Compensia; NAM; and SCG 1.

[144] Some commenters recommended limiting the definition to the issuer's named executive officers as defined in 17 CFR 229.402(a)(3). *See, e.g.,* comment letter from Duane; FedEx 1; Fried; Hay Group; and NACD. Other commenters recommended limiting the definition to only the principal executive officer, principal financial officer, principal accounting officer (or if there is no such accounting officer, the controller), and, in addition, any officer in charge of a principal business unit, division, or function or who performs a policy-making function and whom the board of directors or compensation committee determines to have had an important role in contributing to the events leading to a financial restatement. *See, e.g.,* comment letters from ABA 1; Chevron; and SCG 1. Still other commenters recommended various forms of scienter requirements. *See, e.g.,* comment letters from American Vanguard; CCMC 1; Coalition; Compensia; and SH&P.

definition would exclude individuals with a significant executive role at an issuer and could be contrary to the interests of investors.[145]

We received limited comment specific to our proposal to base the definition on the Rule 16a-1(f) definition of "officer," instead of the 17 CFR 240.3b-7 ("Rule 3b-7") definition of "executive officer."[146] A few commenters suggested that including all Section 16 officers, without providing the compensation committee discretion in enforcing recovery, may affect issuers' practices in identifying their executive officers.[147]

Several commenters recommended limiting recovery only to incentive-based compensation earned during the portion of the look-back period when the individual was an executive officer of the issuer.[148] Some questioned whether recovery for periods when the individual was serving in non-executive capacities would be consistent with the statute.[149] Others questioned the fairness of applying recovery to periods when an officer was not serving in an executive capacity.[150] Some commenters further expressed concern that this aspect of the proposal would discourage employees from serving as executive officers, with a detrimental

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145 *See, e.g.,* comment letters from AFL-CIO; AFR 1; and Rutkowski 1.

146 *See* comment letters from Keith Paul Bishop ("Bishop") (recommending use of the Rule 3b-7 definition) and CalPERS 1 (supporting use of the Rule 3b-7 definition as an alternative to the proposal).

147 *See* comment letters from ABA 1 (suggesting that some issuers may have an incentive to reevaluate the identification of their "corporate insiders" to see whether they should reduce the number of individuals subject to those rules – particularly where the individual has little or no responsibility for accounting and finance matters); and Pearl Meyer (suggesting the definition may lead some issuers to redefine duties of executive officers in order to limit those subject to recovery). *See also* Compensia.

148 *See, e.g.,* comment letters from ABA 1; CCMC 1; CEC 1; Chevron; Compensia; Davis Polk 1; Duane; Ensco, PLC ("Ensco"); Exxon; FSR; FedEx 1; IBC; Mercer; NACD; and S&C 1. *See also* comment letters in response to the Reopening Release from Davis Polk 3; and McGuireWoods. One commenter additionally suggested granting the board discretion to recover only for the portion of the look-back period when the person was an executive officer. *See* comment letter from Ensco.

149 *See* comment letters from Exxon; and FSR.

150 *See* comment letters from FSR; and SH&P.

impact on corporate governance and the issuer's ability to provide for smooth transitions.[151] In contrast, one commenter expressly supported the proposal.[152]

c. Final Amendments

After considering the comments, we are adopting the rules defining executive officers subject to recovery substantially as proposed, with modifications in response to commenters.[153] Section 10D uses the term "executive officer" to identify the persons who are to be subject to the rules without reference to a specific scope or defined term. As described above, while Congress did not intend to cover rank-and-file employees, it also did not limit the scope of recovery to those officers who may be "at fault" for accounting errors that led to a restatement, nor to those who are directly responsible for the preparation of the financial statements.

In developing the definition of "executive officer" for purposes of Rule 10D-1, we considered the statutory purpose of the rule. First, Section 10D seeks to recover erroneously awarded incentive-based compensation, reducing a potential form of unjust enrichment, in which executive officers would gain from accounting errors at the expense of shareholders. The statute thus protects shareholders from bearing the economic burden of erroneously awarded compensation derived from material noncompliance with financial reporting requirements. The statute also helps to maintain investor confidence in markets and improve liquidity by incentivizing executive officers to provide more accurate financial reporting. While some commenters recommended that we use our discretion to apply Section 10D to a limited set of executive officers, such as named executive officers, executive officers who had a role in

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[151] *See* comment letters from Davis Polk 1; IBC; and S&C 1.

[152] *See* comment letter from CalPERS 1.

[153] *See* 17 CFR 240.10D-1(b)(1)(i) ("Rule 10D-1(b)(1)(i)") and the definition of "executive officer" in 17 CFR 240.10D-1(d) ("Rule 10D-1(d)").

preparing the financial statements, or executive officers who had a role in the accounting error leading to the restatement, we are not persuaded that such limitations would be consistent with Congress' goals. Further, Congress' use of the unqualified term "executive officer" in Section 10D, compared to its application of qualifiers to that term elsewhere in the Dodd-Frank Act, suggests that it did not intend to limit the group of executive officers subject to recovery."[154]

We also acknowledge commenters who recommended that we base the definition on Rule 3b-7.[155] The term "executive officer" as defined in 17 CFR 240.3b-7 and the term we are adopting are similar. However, we determined to establish a definition of "executive officer" in Rule 10D-1 in order to expressly include officers with an important role in financial reporting. This includes an issuer's president, principal financial officer, and principal accounting officer (or if there is no such accounting officer, the controller), which we note is consistent with the term "officer" as defined in Rule 16a-1(f). 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 essential that officers with an important role in financial reporting be subject to the recovery policy, which is expected to further incentivize high-quality financial reporting.

At the same time, because Congress broadly intended Section 10D to ensure that erroneously awarded compensation be returned to the issuer, we do not agree with commenters who suggested that the scope of the rule should be limited to only officers with a direct role in financial reporting. Further, including officers with policy-making functions or important roles

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[154] We note, for example, that Section 952 of the Dodd-Frank Act uses the term "named executive officer" and Section 953 directly refers to 17 CFR 229.402, which makes extensive use of the term "named executive officer".

[155] *See supra* note 146.

in the preparation of financial statements in the definition of "executive officer" for purposes of Rule 10D-1 will ensure that the recovery policy requirements have the additional benefits of providing executive officers with an increased incentive to reduce the likelihood of inadvertent misreporting and of reducing the financial benefits to executive officers from failures to accurately account for the issuer's results. Because officers with policy making functions or important roles in the preparation of financial statements play an important managerial role and help set the tone at the top, ensuring that the required recovery policy will apply to any such officers may enhance these benefits. Further, requiring the issuer to establish a direct connection between an executive officer and a material error would add significant time, uncertainty, and litigation risk to recovery determinations, which in turn would increase costs to the issuer and its shareholders.

Further, the definition of "executive officer" we are adopting, like the Rule 16a-1(f) definition of "officer," 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. Identification of an executive officer for purposes of this section would include, at a minimum, executive officers identified pursuant to 17 CFR 229.401(b).[156] With respect to commenters who indicated that issuers may have an incentive to mischaracterize an officer determination, we remind issuers that such a determination must be an objective determination without regard to whether that officer is subject to a recovery policy.

We also concluded that applying additional scienter or responsibility requirements as suggested by some commenters would run counter to the intent of the statute. Section 10D does not require the issuer to establish scienter before it may recover erroneously awarded incentive-

[156] *See* Rule 10D-1(d), modeled on the Note to Rule 16a-1(f).

based compensation, nor does the statute limit recovery to executive officers who were directly involved with the accounting error. This suggests that Congress intended that the recovery policy be implemented without regard to the fault of the executive officers for the accounting errors. In this regard, we believe Section 10D was established not to punish wrongdoing, but to require executive officers to return monies that rightfully belong to the issuer and its shareholders.

The statute specifically requires recovery from any current or former executive officers of the issuer who received incentive-based compensation in excess of what would have been paid to the executive officer under the accounting restatement. Section 10D(b)(2) expressly states that the recovery policy must apply to "any current or former executive officer of the issuer." We believe recovery from former executive officers is appropriate because otherwise, such individuals would be in a position to improperly benefit from material errors that occurred during their tenure as executive officers at the issuer.[157]

We agree, however, with commenters who suggested that requiring recovery from individuals for incentive-based compensation received prior to the period when they became an

[157] The final amendments do not distinguish between former executive officers that leave a company, retire, or transition to an employee role (including after serving as an executive officer in an interim capacity) during the recovery period. We disagree with commenters who suggest that an individual who serves as an executive officer and then transitions to an employee role should not be subject to recovery of incentive based compensation received while serving as an employee. Section 10D-1 specifically applies to "former executive officers" and does not distinguish among types of former executive officers. Moreover, any former executive officer who is now an employee who receives incentive-based compensation that would be affected by the recovery policy is receiving compensation that, had the issuer's financial statements not been in error, the individual would not have received. Similarly, while we acknowledge commenters' concerns regarding the application of the statute and the rules to interim executive officers, the recovery policy would only apply if such interim (and former interim) executive officers received erroneously awarded compensation as a result of errors in the financial statements. Like retired executives, such individuals would be in a position to benefit from erroneously awarded compensation as a result of such errors. The potential for such benefit would weaken the individual's incentives to ensure accurate financial statements while they were serving as an executive.

executive officer may not serve the goals of the statute.[158] Therefore, in a change from the proposal, the final rule will only require recovery of incentive-based compensation received by a person (i) after beginning service as an executive officer and (ii) if that person served as an executive officer at any time during the recovery period.[159] Recovery of compensation received while an individual was serving in a non-executive capacity prior to becoming an executive officer will not be required.[160]

We further note that the recovery requirement also does not apply to an individual who is an executive officer at the time recovery is required if that individual was not an executive officer at any time during the period for which the incentive-based compensation is subject to recovery. Nevertheless, nothing in the rule would limit an issuer's compensation recovery policy from requiring recovery more broadly.

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

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158 *See supra* note 150.

159 *See* 17 CFR 240.10D-1(b)(1)(i)(A) and (B). The rule further provides that the recovery policy applies to incentive-based compensation received while the issuer has a class of securities listed on an exchange and during the three completed fiscal years immediately preceding the date that the issuer is required to prepare an accounting restatement. *See* 17 CFR 240.10D-1(b)(1)(i)(C) and (D).

160 *Id*. Note that an award of incentive-based compensation granted to an individual before the individual becomes an executive officer will be subject to the recovery policy, so long as the incentive-based compensation was received by the individual at any time during the performance period after beginning service as an executive officer.

compensation received in the three-year look-back period would have been less if the financial statements originally had been prepared as later restated.

i. Proposed Amendments

The Commission proposed to define "incentive-based compensation" in a principles-based manner as "any compensation that is granted, earned or vested based wholly or in part upon the attainment of any financial reporting measure." The proposed definition further provided 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, any measures derived wholly or in part from such financial information, and stock price and total shareholder return ("TSR"). 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.

ii. Comments

We received a range of comments relating to the proposed definition of "incentive-based compensation." Some commenters endorsed the proposed principles-based approach to defining "incentive-based compensation.[161] Other commenters recommended that the definition leverage existing executive compensation disclosure requirements and look to the existing definition of "incentive plan."[162] We also received a range of comments relating to the types of awards that

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[161] *See, e.g.,* comment letters from Better Markets 1; CalPERS 1; CFA Institute 1; and OPERS 1. Commenters generally did not see the need for anti-evasion provisions. *See, e.g.,* comment letters from Better Markets 1; CalPERS 1; and NACD. *But see* comment letter from OPERS 1.

[162] *See, e.g.,* comment letters from ABA 1 (recommending including only awards already reported in an issuer's executive compensation disclosure and reported in the equity incentive plan and non-equity incentive plan awards columns of the Grants of Plan-Based Awards Table pursuant to 17 CFR 229.402(d) that are granted, earned or vested based wholly or in part upon attainment of a financial reporting measure); and Kovachev (recommending reference to the 17 CFR 229.402(a)(6)(ii) definition of "incentive plan," excluding compensation determined by metrics such as market share or customer satisfaction).

should be covered. Some commenters recommended that the Commission expand the definition to include subjective awards as covered incentive-based compensation,[163] while others objected to recovering compensation based on qualitative or discretionary standards.[164] Similarly, a number of commenters expressed concern about excluding, or recommended including, time- or service-based awards.[165] Other commenters supported excluding time- or service-based awards[166] and awards based on attaining nonfinancial measures.[167] Some of these commenters requested specific confirmation that time-based equity awards are not considered incentive-based compensation for purposes of the rule.[168] Some commenters supported having the rule also apply to deferred compensation as proposed;[169] however, several other commenters expressed concern that application to deferred compensation plans and pension plans could violate the

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[163] *See, e.g.,* comment letters from Better Markets 1 (recommending a presumption that all incentive-based compensation is based in whole or in part on financial reporting measures); and Public Citizen 1 (recommending similar levels of recovery of all incentive-based compensation). *See also* comment letter from CFA Institute 1 (recommending board discretion to recover compensation based on satisfying subjective standards to the extent the subjective standards are satisfied in whole or in part by meeting a financial reporting measure performance goal) and comment letter in response to the Reopening Release form ICGN (recommending including ESG-related metrics).

[164] *See, e.g.,* comment letters from FSR; Kovachev (contending that including discretionary bonuses would be beyond the scope of the statute); and NACD. *See also* comment letter from ABA 1 (noting that subjective awards do not lend themselves to formulaic re-creation).

[165] *See, e.g.,* comment letters from AFL-CIO (recommending that for stock options awarded as compensation the board make reasonable estimates of the effect on stock price); and Pay Governance (suggesting that excluding service-based equity awards could create an incentive to grant more such awards, thus shifting away from pay-for-performance).

[166] *See, e.g.,* comment letters from ABA 1; CEC 1; Chevron; Compensia; Davis Polk 1; FedEx 1; Japanese Bankers; Kovachev; and SCG 1.

[167] *See* comment letter from FedEx 1. *See also* Kovachev (recommending defining covered equity awards by referencing compensation reported in the Estimated Future Payouts Under Equity Incentive Plan Awards column of the Grants of Plan-Based Awards table provided pursuant to 17 CFR 229.402(c)).

[168] *See, e.g.,* comment letters from Chevron; Compensia; and SCG 1. These commenters were concerned that the stock price metric included in the proposed definition could be read to include an equity award for which value is determined based on stock price but vests solely upon completion of a specified employment period or passage of time.

[169] *See* comment letters from AFR 1; and Rutkowski 1.

Internal Revenue Code or Employee Retirement Income Security Act ("ERISA").[170]

We received a number of comments on the proposed inclusion of TSR/stock price metrics. Some commenters expressly supported inclusion of these metrics,[171] some commenters expressed qualifications or reservations but did not object to their inclusion,[172] and other commenters expressly opposed inclusion of stock price/TSR metrics.[173] Commenters opposed to inclusion of these metrics noted the costs, uncertainty, and subjectivity of calculating recoverable amounts,[174] questioned the proposed definition of "incentive-based compensation,"[175] expressed

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[170] *See, e.g.,* comment letters from ABA 1; Exxon; FSR; IBC; Mercer; SCG 1; Sutherland Asbill & Brennan LLP ("Sutherland"); and WAW. *But see* comment letter from ABA 1 (noting that the forfeiture of excess incentive-based compensation deferred into a holdback plan as a recovery mechanism would be permissible and would not result in an accelerated payment under Section 409A of the Internal Revenue Code). *See* discussion relating to the exemption for tax-qualified retirement plans in Section II.B.3.b.iii.

[171] *See, e.g.,* comment letters from AFR 1; Better Markets 1 (suggesting that these metrics fall within the ambit of the statutory formulation, which broadly encompasses all compensation "based on financial information required to be reported under the securities laws" and provides for recovery of excessive compensation "based on" erroneous data and that because stock price and TSR are widely used in calculating executive compensation their exclusion would substantially undermine the attainment of the objectives underlying Section 10D); CalPERS 1; and Rutkowski 1 (suggesting that inclusion is appropriate because stock price is based on investor expectation of cash flows, which are in turn deeply informed by accounting metrics).

[172] See*, e.g.,* comment letters from CFA Institute 1 (noting that establishing a link between financial errors and a change in stock price would be easier in cases of fraud that are meant to directly affect stock price); Compensia (expressing concern regarding how to calculate the amounts subject to recovery); and OPERS 1.

[173] *See, e.g.,* comment letters from ABA 1; BRT 1; Davis Polk 1; FSR; FedEx 1; Fried; IBC; Japanese Bankers; Mercer; Meridian Compensation Partners LLC ("Meridian"); NACD; Pearl Meyer; and SH&P. *See also* comment letters in response to the Reopening Release from Cravath, McGuireWoods; and Hunton.

[174] *See, e.g.,* comment letters from Davis Polk 1; FedEx 1; Fried; FSR; IBC (suggesting that analyses by third-party advisors are expensive, highly speculative, and imprecise); Mercer (citing the study of restatements by the Center for Audit Quality considered in the Proposing Release to show that restatements at over 4,000 companies caused only an average 1.5% decline in stock price and a median decline of 0.01%. The average impact of restatements as a result of a material error was slightly higher (-2.3%), but the median was also near zero%); and SH&P. Some of these commenters suggested that the subjectivity of calculating the amounts for stock price/TSR metrics would be incompatible with the no-fault standard of the proposed rule. *See, e.g.,* comment letters from Davis Polk 1; FedEx 1; and SH&P (further recommending that due to the subjectivity, recovery should be at the discretion of the board). *See also* comment letters in response to the Reopening Release from Cravath; Hunton; and McGuireWoods (suggesting that calculating the amounts would be difficult and would require additional economic analysis by issuers).

[175] *See, e.g.,* comment letter from ABA 1 (recommending that the present disclosure requirements under Item 402 of Regulation S-K adequately define the types of compensation that should be considered "incentive-based compensation" for purposes of Section 10D: that is non-equity incentive plan awards as reported in columns (c) through (e) of the Grants of Plan-Based Awards table pursuant to 17 CFR 229.402(d)(2)(iii) and equity

concern over the potential for litigation from shareholders or executive officers challenging the amount determined,[176] questioned the statutory authority to cover the metrics,[177] and suggested that the metrics' inclusion could discourage the use of TSR as a performance measure.[178] Another commenter recommended providing a safe harbor for determining the amount subject to recovery if stock price and TSR metrics are included.[179]

iii. Final Amendments

After considering the statutory language of Section 10D, the views of commenters, and the administrability of any mandatory recovery policy that encompasses incentive-based compensation, we are adopting substantially as proposed the defined term "incentive-based compensation."[180] Specifically, for purposes of Rule 10D-1, we are defining "incentive-based compensation" to be "any compensation that is granted, earned, or vested based wholly or in part upon the attainment of any financial reporting measure."[181] We determined to define the term in

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incentive plan awards as reported in columns (f) through (h) of that table pursuant to 17 CFR 229.402(d)(2)(iv)).

176 *See* comment letters from Davis Polk 1; and FSR.

177 *See* comment letters from ABA 1; Meridian (suggesting that implicit in the determination of excess incentive-based compensation is that the reach of Section 10D is limited to incentive-based compensation that is linked to the achievement of specific financial metrics); and NACD. *See also* comment letters in response to the Reopening Release from ABA 1 (suggesting it is inconsistent with the statutory mandate to include either an issuer's stock price or its TSR in such definition as each measure reflects many factors beyond the issuer's reported financial information, the sole criterion set forth in Section 10D); and McGuireWoods (suggesting the term is limited to financial reporting measures used in preparing the issuer's financial statements that are accounting-based metrics).

178 *See, e.g.,* comment letter from FSR (suggesting that avoiding the use of TSR could be problematic in light of proposed "pay-versus-performance" rules requiring issuers to disclose the relationship between company performance as reflected by TSR and the compensation paid).

179 *See* comment letter in response to the Reopening Release from McGuireWoods.

180 *See* Rule 10D-1(d). The definition applies only to recovery of incentive-based compensation under proposed Rule 10D-1, and does not apply to the recovery of incentive-based compensation pursuant to 15 U.S.C. 7243 ("Sarbanes-Oxley Act Section 304").

181 "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% of the target amount is earned if a certain revenue level is achieved, and 40% of the target amount is earned if a certain number of new

a principles-based manner so that the rule will capture new forms of compensation that are developed and new measures of performance upon which compensation may be based. As noted above, any incentive-based compensation recovered under the final rules is compensation that an executive officer would not have been entitled to receive had the financial statements been accurately presented. A number of the alternatives recommended by commenters would omit incentive-based compensation received outside of an incentive plan. Allowing executive officers to retain such incentive-based pay when it was erroneously awarded based on material accounting errors would undermine the statutory purpose of Section 10D to recover these amounts for the benefit of issuers and their shareholders. Absent recovery of such compensation, executive officers would still be in a position to benefit from accounting errors, undermining their incentives to ensure reliable financial reporting. Further, gaps in the forms of incentive-based pay that would be subject to recovery might encourage issuers to shift compensation towards omitted categories, further undermining the purpose of the rule.

Consistent with the proposal, we are defining "financial reporting measures" to be measures that are determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements, and any measures derived wholly or in part from such measures.[182] This includes "non-GAAP financial measures" for purposes of Exchange Act Regulation G and 17 CFR 229.10 as well other measures, metrics and ratios that are not non-

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.

[182] *See* Rule 10D-1(d).

GAAP measures, like same store sales.[183] Financial reporting measures may or may not be included in a filing with the Commission, and may be presented outside the financial statements, such as in Management's Discussion and Analysis of Financial Conditions and Results of Operations[184] or the performance graph.[185]

In order to provide guidance to issuers, we reiterate the examples of financial reporting measures provided in the Proposing Release, including, but not limited to, the following accounting-based measures and measures derived from:

- Revenues;
- Net income;
- Operating income;
- Profitability of one or more reportable segments;[186]
- Financial ratios (*e.g.*, accounts receivable turnover and inventory turnover rates);
- Net assets or net asset value per share (*e.g.*, for registered investment companies and business development companies that are subject to the rule);
- Earnings before interest, taxes, depreciation and amortization;
- Funds from operations and adjusted funds from operations;
- Liquidity measures (*e.g.*, working capital, operating cash flow);
- Return measures (*e.g.*, return on invested capital, return on assets);

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[183] *See Conditions for Use of Non-GAAP Measures*, Release No. 33-8176 (Jan. 22, 2003) [68 FR 4820 (Jan. 20, 2003)] and *Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations*, Release No. 33-10751 (Jan. 30, 2020) [85 FR 10571 (Feb. 25, 2020)].

[184] 17 CFR 229.303. *See also* Item 5, Form 20-F. Examples of such measures could be accounts receivable turnover, Earnings before interest, taxes, depreciation and amortization, or sales per square foot.

[185] 17 CFR 229.201(e).

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

- 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, the definition of "financial reporting measures" also includes stock price and TSR, as proposed.[187] As the Commission noted in the Proposing Release, 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." We note that Congress' direction to include compensation that is "based on" financial information and to recover compensation "based on" the erroneous accounting data suggests Congress' intent to provide an expansive reading of those terms. The final rule therefore encompasses incentive-based compensation tied to measures such as stock price and TSR because improper accounting affects such measures and in turn results in excess compensation.[188]

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[187] In a nonsubstantive modification from the proposal, we have broken out the inclusion of stock price and TSR in a separate clause of the definition. By including a separate clause in the definition, instead of using the conjunctive "and," the modification makes clear that stock price and TSR are financial reporting measures.

[188] One commenter recommended using the definition of "incentive plan award" in 17 CFR 229.402(a)(6)(iii) of Regulation S-K, which includes "any other performance measure." *See* comment letter from ABA 1. Using the existing definition of "incentive plan award" to define "incentive-based compensation" would apply the recovery to a different scope of incentive compensation. The Rule 10D-1 definition does not include "other

Although the phrase "financial information required to be reported under the securities laws" might be interpreted as applying only to accounting-based metrics, in consideration of the statutory purpose described above, we have determined that it is appropriate to interpret the term to include performance measures including stock price and TSR that are affected by accounting-related information and that are subject to our disclosure requirements. Stock price and TSR are frequently used incentive-based performance metrics for executive compensation, such that excluding them could lead issuers to alter their executive compensation arrangements in ways that would avoid application of the mandatory recovery policy, undermining the objectives of the rule, as well as impacting efficient incentive alignment. While some commenters recommended that we narrow the scope of the definition, we agree with other commenters that supported a broader reading of the definition.[189]

We disagree with the contention put forth by some commenters that Section 10D is limited to incentive-based compensation that is linked to the achievement of specific financial metrics. Section 10D requires 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." The use of the term "based on" is expansive and the statute does not explicitly delineate the types of financial information that should be considered. Section 10D(b) separately requires the issuer to recover from any current or former executive officer of the issuer who received "incentive-based compensation . . . based on the erroneous data." As we have previously noted, if an executive officer erroneously receives incentive-based compensation based on stock price

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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.

[189] As one commenter noted, stock price is at least in part based on investor expectation of cash flows, which is intrinsically tied to a company's financial statement disclosures. *See supra* note 171.

or TSR that was inaccurate as a result of an accounting misstatement, that compensation is based on such erroneous data.[190] Being mindful of the statutory language and purpose of Section 10D, we do not see a basis for allowing that executive officer to retain such compensation, given that it was erroneously awarded. Absent recovery of such compensation, certain executive officers would be in a position to benefit from accounting errors, undermining their incentives to ensure reliable financial reporting. We therefore believe that inclusion of incentive-based compensation based on stock price and TSR is necessary and appropriate for the implementation of Section 10D. Adopting a narrower definition of "incentive-based compensation" or "financial reporting measures" would result in the failure to recover from executive officers incentive-based compensation that was erroneously awarded to them, and therefore would be less effective in achieving the goals of the statute.

We recognize, as some commenters noted, concerns relating to costs, uncertainty, and subjectivity of calculating amounts of recoverable erroneously awarded compensation with respect to the calculation of stock price and TSR. These commenters highlighted that, once an issuer concludes that its compensation is incentive-based compensation for the purposes of this rule, issuers may need to engage in complex analyses that require technical expertise and specialized knowledge and may involve substantial exercise of judgment in order to determine the stock price impact of the error that led to a restatement. Due to the presence of confounding factors, it may be difficult to establish the relationship between an accounting restatement and the stock price.

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[190] We note that Rule 10D-1 applies only to erroneously awarded incentive-based compensation based on stock price or TSR that was inaccurate as a result of the issuer's accounting restatement. For example, if the issuer is using TSR where the performance measure is linked to a peer group (such as relative TSR), only an accounting restatement by the issuer, not accounting restatements by other issuers in the peer group, would result in application of the rule and potential recovery.

While we recognize these challenges, we believe the additional costs associated with these factors are justified in order to better achieve the objectives of the statute, as outlined above. 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 erroneously awarded compensation to be recovered following an accounting error. In an accommodation to address concerns relating to costs, uncertainty, and subjectivity of calculating these amounts, Rule 10D-1 permits issuers to use reasonable estimates when determining the impact of a restatement on stock price and TSR.[191] Allowing the use of 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.[192] Further, since "little r" restatements are less likely to be associated with significant stock price reactions, we expect that recovery of incentive-based compensation as a result of "little r" restatements that is tied to TSR would be relatively small and infrequent, which should further mitigate these costs.[193]

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 and as proposed, the definition of "incentive-based

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[191] *See* 17 CFR 240.10D-1(b)(1)(iii)(A) ("Rule 10D-1(b)(1)(iii)(A)"). In addition, 17 CFR 240.10D-1(b)(1)(iii)(B) ("Rule 10D-1(b)(1)(iii)(B)") requires the issuer to maintain documentation of the determination of that reasonable estimate and provide such documentation to the exchange or association as proposed. In a modification from the proposal, 17 CFR 229.402(w)(1)(i)(C) additionally requires disclosure of the estimates that were used in determining the erroneously awarded compensation attributable to an accounting restatement and an explanation of the methodology used to estimate the effect on stock price or TSR, if the financial reporting measure related to a stock price or TSR metric, to better explain how the issuer established its estimates. *See* Section II.D.3.

[192] We acknowledge that implementation of a safe harbor could further mitigate potential concerns about the difficulties and costs of calculating recovery amounts. As discussed in more detail in Section II.B.3.a.iii, we believe that permitting reasonable estimates will sufficiently mitigate these potential difficulties.

[193] *See* discussion *infra* at note 400.

compensation" in the final rule includes options and other similar equity awards whose grant or vesting is based wholly or in part upon the attainment of financial reporting measures.

Specific examples of "incentive-based compensation" include, but are not 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;
- Other cash awards based on satisfaction of a financial reporting measure performance goal;
- Restricted stock, restricted stock units, performance share units, 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 is not "incentive-based compensation" for this purpose include, but are not limited to:

- Salaries;[194]
- Bonuses paid solely at the discretion of the compensation committee or board that are not paid from a "bonus pool" that is determined by satisfying a financial reporting measure performance goal;

[194] 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 performance goal, such a salary increase is subject to recovery as a non-equity incentive plan award for purposes of Rule 10D-1.

- 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 nonfinancial reporting measures.[195]

b. When Compensation is "Received" and Time Period Covered

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 erroneously awarded 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 or specify when an executive officer should be deemed to have received incentive-based compensation for the recovery policy required under the applicable listing standards.

i. Proposed Amendments

The Commission proposed that incentive-based compensation would be deemed "received" for purposes of triggering a recovery policy in the fiscal period during which the

[195] This statement responds to commenters' questions and concerns regarding the treatment of time-based and service-based equity awards.

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. As proposed, 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.

The Commission further proposed that 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. Where an issuer has changed its fiscal year end during the three-year look-back period, the Commission proposed 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).

ii. Comments

We received limited comment regarding clarification of when compensation is received and establishing the time period to be covered by the listing standard. Some commenters supported the proposed definition of when compensation is deemed "received."[196] In contrast, one commenter suggested that the proposed definition was overly broad.[197]

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[196] *See* comment letters from ABA 1 (noting the proposal is consistent with Item 402 reporting requirements and how most issuers view the receipt of incentive-based compensation); Better Markets 1; CFA Institute 1; and CEC 1 (suggesting the time gap between when the award's financial metric is achieved and the date the executive obtains control over the award may allow an issuer to seek recovery by cancelling the affected portion of the award). However, two of these commenters were split on the proposal to limit recovery only to the extent that compensation was received while the issuer has a class of securities listed on an exchange, with one in favor (ABA 1) and one opposed (Better Markets 1).

[197] *See* comment letter from NACD (noting that just because a reward is granted, earned, or vests does not mean that it is actually received).

One commenter expressly supported the three-year period as a reasonable period of time,[198] another recommended issuer discretion to select the appropriate time period,[199] and a third noted that accounting restatements may take place a considerable time after erroneous payments were made, and recommended that the look-back period should be extended to at least five years.[200] In addition, while one commenter expressly supported the proposed use of fiscal years as consistent with the statutory language and minimizing the potential for confusion,[201] another suggested that existing issuer recovery policies do not use the term "fiscal year."[202]

iii. Final Amendments

After considering the views of commenters, we are adopting the rules relating to when compensation is "received" and the time period covered substantially as proposed.[203] Incentive-based compensation will be deemed received for purposes of the recovery policy under Section 10D in the fiscal period[204] 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.[205] Under the rules, incentive-based compensation is subject to the issuer's recovery policy to the extent that it is received while the issuer has a class of securities listed on

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198 *See* comment letter from CFA Institute 1.

199 *See* comment letter from NACD.

200 *See* comment letter from As You Sow 1.

201 *See* comment letter from CEC 1.

202 *See* comment letter from Bishop.

203 *See* Rule 10D-1(b)(1)(i). In a nonsubstantive modification from the proposal, we are no longer including "(f)or purposes of Section 10D" in the definition of "received" in Rule 10D-1(d) as the introductory portion of Rule 10D-1(d) makes clear that the definitions are for purposes of the section. We additionally simplified the language in Rule 10D-1(b)(1)(i)(B) to clarify the meaning of transition period for purposes of the rule without defining the term.

204 Including a transition period for a change in fiscal year, if applicable.

205 *See* Rule 10D-1(d).

an exchange or an association.[206] Further, the time period covered for the recovery policy will be the three completed fiscal years immediately preceding the date the issuer is required to prepare an accounting restatement.[207]

The date of receipt of the compensation depends upon the terms of the award. For example,

- If the grant of an award is based, either wholly or in part, on satisfaction of a financial reporting measure performance goal, the award would be deemed received in the fiscal period when that measure was satisfied;
- If an equity award vests only upon satisfaction of a financial reporting measure performance condition, the award would be deemed received in the fiscal period when it vests;[208]
- A non-equity incentive plan award would be deemed received in the fiscal year that the executive officer 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;[209] and

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[206] *See* 17 CFR 240.10D-1(b)(1)(i)(A). After considering comments, we continue to believe that the statute calls for recovery limited to compensation that is received while the issuer has a class of securities listed on an exchange or an association. We note that an award of incentive-based compensation granted to an executive officer before the issuer lists a class of securities will 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 is not required to be subject to the recovery policy.

[207] Including a transition period for a change in fiscal year, if applicable. *See* Rule 10D-1(b)(1)(i)(B).

[208] *See infra* notes 210 and 211.

[209] 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 17 CFR 229.402(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."

- A cash award earned upon satisfaction of a financial reporting measure performance goal would be deemed received in the fiscal period when that measure is satisfied.

We further note that a particular award may be subject to multiple conditions and that an executive officer need not satisfy all conditions to an award for the incentive-based compensation to be deemed received for purposes of triggering the recovery policy. 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," we believe that the executive officer "receives" the compensation for purposes of a 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.[210] 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, do not affect the determination of the date received.[211]

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[210] We disagree with the commenter that suggested the proposed definition was overly broad. We believe this definition is appropriate for the recovery policy to capture the appropriate amounts of compensation subject to recovery. For example, an issuer could grant an executive officer restricted stock units in which the number of units earned is determined at the end of the three-year incentive-based performance period (2020-2022), but the award is subject to service-based vesting for two more years (2023-2024). Although the executive officer does not have a non-forfeitable interest in the units before expiration of the subsequent two-year service-based vesting period, the number of shares in which the units ultimately will be paid will be established at the end of the three-year performance period which is when the relevant financial reporting measure performance goal is attained. If the issuer's board of directors concludes in 2023 that the issuer will restate previously issued financial statements for 2020 through 2022 (the three-year performance period), the recovery policy should apply to reduce the number of units ultimately payable in stock, even though the executive officer has not yet satisfied the two-year service-based vesting condition to payment. To the extent that an executive officer fails to then meet the service vesting period and never actually receives the compensation, the compensation forgone as a result of the failure to meet the vesting period would be the reduced compensation as a result of the recovery policy.

[211] For example, as stated above, an equity award granted upon attainment of a financial reporting measure would be deemed received 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. The fiscal year in which an incentive-based equity award is deemed received 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].

The three-year look-back period for the recovery policy will comprise the three completed fiscal years immediately preceding the date the issuer is required to prepare an accounting restatement for a given reporting period.[212] We recognize that some commenters recommended different lengths of time for the look-back period; however, the final rules are consistent with the statute, which explicitly contemplates a three-year look-back.[213] Basing the look-back period on fiscal years, rather than a preceding 36-month period, is consistent with the statutory language and issuers' general practice of making compensation decisions and awards on a fiscal year basis.[214] As an example, if a calendar year issuer concludes in November 2024 that a restatement of previously issued financial statements is required and files the restated financial statements in January 2025, the recovery policy would apply to compensation received in 2021, 2022, and 2023. 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. Moreover, an issuer will 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.[215] In situations where an issuer has changed its fiscal year end during the three-year look-back period, the issuer must recover any excess incentive-based compensation received during the transition period occurring during, or

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212 *See* Rule 10D-1(b)(1)(i)(B).

213 *See* discussion in Section II.B.2 regarding the date an issuer is required to prepare an accounting restatement for purposes of Rule 10D-1.

214 While we recognize, as one commenter noted, that some recovery policies may not use fiscal years, we have determined to use that term because the term is well understood and consistent with the statutory language.

215 *See* Rule 10D-1(b)(1)(i)(B).

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).[216]

3. Recovery Process

a. Calculation of Erroneously Awarded 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."

i. Proposed Amendments

The Commission proposed to define the amount of incentive-based compensation that must be subject to the issuer's recovery policy ("erroneously awarded compensation") 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."[217] For incentive-based compensation that is based on stock price or TSR, where the amount of erroneously awarded compensation is not subject to mathematical recalculation directly from the information in an accounting restatement, the Commission proposed that the erroneously awarded compensation amount may be determined based on a reasonable estimate of the effect of the accounting

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[216] *Id*. 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. 17 CFR 240.13a-10 and 17 CFR 240.15d-10. For example, if in late 2021, an issuer changes its fiscal closing date from June 30 to Dec. 31, it would subsequently report on the transition period from July 1, 2021 to Dec. 31, 2021. If the issuer's board of directors concludes in May 2023 that it is required to restate previously issued financial statements, the look-back period would consist of the year ended June 30, 2020, the year ended June 30, 2021, the period from July 1, 2021 to Dec. 31, 2021, and the year ended Dec. 31, 2022. However, consistent with 17 CFR 210.3-06(a), a transition period of nine to 12 months would be considered a full year in applying the three-year look-back period requirement.

[217] *See* Proposed Rule 10D-1(b)(1)(iii).

restatement on the applicable measure and that the issuer shall maintain documentation of that reasonable estimate and provide it to the exchange. The Commission further proposed that the erroneously awarded compensation would be calculated on a pre-tax basis.[218]

Additionally, in the Proposing Release, the Commission provided guidance relating to the amount to be recovered when discretion was exercised in the original grant and stated that Rule 10D-1 would not permit issuers' boards of directors to pursue differential recovery among executive officers, including in "pool plans,"[219] where the board may have exercised discretion as to individual grants in allocating the bonus pool.

ii. Comments

We received varying comments on how excess compensation subject to recovery should be determined. Some commenters expressed concern regarding issuers' ability to determine the amount of erroneously awarded compensation.[220] Other commenters recommended that the Commission provide additional guidance regarding calculating recoverable amounts for specific forms of compensation, such as stock options, profits from the sale of securities, and awards

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[218] *Id.* (providing that the erroneously awarded compensation must be computed without regard to any taxes paid by the executive officer). Under the proposal, the erroneously awarded compensation would be determined based on the full amount of incentive-based compensation received by the executive officer, rather than the amount remaining after the officer satisfies the officer's personal income tax obligation on it.

[219] "Pool plans" are 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 executive officers are based on discretion.

[220] *See* comment letters from Coalition; Osler, Hoskin & Harcourt ("Osler"); and TELUS. Two of these commenters asserted that calculation of the amount would require the exercise of judgement and estimation. *See* comment letters from Osler; and TELUS.

where discretion to reduce the award had been used in determining the size of the original award.[221] A few commenters also expressed concern about duplicative recovery.[222]

We received limited comment regarding the amount to be recovered when discretion was exercised in the original grant. One commenter recommended that recovery should not apply to a pool plan that does not have a minimum financial performance requirement,[223] and another commenter supported allowing discretion as to the amount recoverable if discretion was used to determine the original award amount.[224] A few commenters recommended board discretion on various other aspects of recovery.[225]

One commenter expressly supported the proposal to require issuers to maintain documentation of their determination of the reasonable estimate, but said it should be provided to the exchange upon the exchange's request rather than in all circumstances.[226] Another commenter similarly recommended that issuers be required to provide documentation of the estimate to the exchange only upon request, subject to confidentiality assurances.[227] Some commenters, however, opposed the idea that issuers should be required to provide the information.[228]

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221 *See* comment letters from ABA 1; Compensia; IBC; Japanese Bankers; Kovachev; and Mercer.

222 *See* comment letters from CCMC 1; Coalition; and FSR (noting that the proposal would credit recovery under Sarbanes-Oxley Act Section 304 and recommending extending the relief to recovery of compensation under other compensation recovery policies).

223 *See* comment letter from NACD.

224 *See* comment letter from ABA 1. *See also* comment letter from SH&P (supporting revisiting the use of discretion applied in granting the original award based on the new information from the restatement).

225 *See* comment letters from Compensia (recommending discretion over whether to settle a recovery obligation for less than the full amount); and Technical Compensation Advisors, Inc. ("TCA") (recommending discretion over which executives to recover from, the amount to recover from each, and the timing of repayment).

226 *See* comment letter from Compensia.

227 *See* comment letter from ABA 1.

228 *See* comment letters from Osler; and TELUS.

Some commenters expressed concern regarding the proposed requirement that an issuer establish a reasonable estimate of the effect of the accounting restatement on the applicable measure as it relates to stock price and TSR.[229] Other commenters recommended that the Commission provide additional guidance, or a safe harbor, for calculating "reasonable estimates."[230] In contrast, one commenter expressed support for the proposed requirement and recommended disclosure of the results for each executive officer.[231]

Some commenters expressed concern regarding recovery on a pre-tax basis and recommended that amounts should be recovered after taxes.[232] Other commenters expressed concern over the effect that tax law could have on the recovery.[233]

iii. Final Amendments

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[229] *See* comment letters from NAM; and SH&P. These commenters noted the numerous factors beyond the financial statements that affect the movement of an issuer's stock price.

[230] *See, e.g.,* comment letters from CEC 1 (recommending that any estimate made in good faith be deemed *per se* reasonable); Chevron; Compensia; Hay Group; Pay Governance; Pearl Meyer; TCA; and WAW. Two of these commenters suggested that issuers may need to engage a valuation expert in some circumstances in order to establish a reasonable estimate. *See* comment letters from Chevron; and Compensia. Others noted the litigation risk and recommended the Commission provide examples, potential methodologies, or a safe harbor. *See* comment letters from Chevron; Pearl Meyer; and TCA. *See also* comment letter from EY (suggesting that some restatements, such as those relating to measurement and recognition of financial assets and liabilities, may have limited impact on stock price or TSR, such that an issuer may reasonably conclude that share price would not have been affected).

[231] *See* comment letter from Public Citizen 1.

[232] *See, e.g.,* comment letters from ABA 1; CEC 1; Davis Polk 1; Duane; FedEx 1; Japanese Bankers; and NACD. Two of these commenters expressed concern that pre-tax recovery could be considered punitive. *See* comment letters from ABA 1; and FedEx 1. *See also* comment letters from ABA 2; Davis Polk 3; and McGuireWoods on the Reopening Release suggesting that recovery of compensation be made on an after-tax basis in order to avoid undue hardship for and an inequitable over-collection from executive officers.

[233] *See, e.g.,* comment letters from Bishop (suggesting that Federal tax law does not permit executives to amend their income tax returns for earlier years which could result in the recovery being considered a financial penalty); Canadian Bankers Association (suggesting that the Canadian Income Tax Act does not provide for executive officers to recover any taxes paid); and Freshfields (suggesting that different outcomes for different individuals in different foreign jurisdictions with divergent recovery rules and tax rates could result in unfair tax impacts).

After considering the views of commenters, we are adopting substantially as proposed that the erroneously awarded compensation under an issuer's recovery policy is "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," computed without regard to taxes paid.[234] The final rules also provide that, for incentive-based compensation based on TSR or stock price, where the amount of erroneously awarded compensation is not subject to mathematical recalculation directly from the information in an accounting restatement, the amount must be based on a reasonable estimate of the effect of the accounting restatement on the applicable measure and the issuer must maintain documentation of the determination of that reasonable estimate and provide it to the exchange. While we recognize some commenters' concerns and requests for additional, specific guidance, including with respect to the calculation of the recoverable amount for specific forms of incentive-based compensation, we believe that the guidance we are providing in this release coupled with the requirement in the final rule to use reasonable estimates of the effect of the accounting restatement provides appropriate direction and flexibility for issuers and exchanges to implement the rule.

Applying this definition, after an accounting restatement, the issuer must first recalculate the applicable financial reporting measure and the amount of incentive-based compensation based thereon. The issuer must then determine whether, based on that financial reporting measure as calculated by relying on the original financial statements and taking into account any discretion that the compensation committee had applied to reduce the amount originally

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[234] *See* 17 CFR 240.10D-1(b)(1)(iii) ("Rule 10D-1(b)(1)(iii)").

received, the executive officer received a greater amount of incentive-based compensation than would have been received applying the recalculated financial reporting measure.[235] Where incentive-based compensation is based only in part on the achievement of a financial reporting measure performance goal, the issuer would first need to determine the portion of the original incentive-based compensation based on or derived from the financial reporting measure that was restated.[236] 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.[237]

For incentive-based compensation that is based on stock price or TSR, where the amount of erroneously awarded compensation is not subject to mathematical recalculation directly from the information in an accounting restatement, the amount of erroneously awarded compensation may be determined based on a reasonable estimate of the effect of the accounting restatement on the applicable measure.[238] 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, and under the final rules, issuers will have flexibility to determine the method that is most

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[235] 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 discretion, the amount of recoverable erroneously awarded compensation would be $200 (*i.e.*, $2,000 - $1,800).

[236] We address bonus pool plans in Section II.B.3.c.

[237] 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 amount of erroneously awarded compensation that would be recoverable 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 (*i.e.*, $4,000 – ($1,800 + $1,000)).

[238] *See* Rule 10D-1(b)(1)(iii)(A).

appropriate based on their facts and circumstances. While we recognize some commenters' concerns and request for additional guidance or a safe harbor, we believe that the requirement to use reasonable estimates of the effect of the accounting restatement provides useful flexibility for issuers to implement the rule, and that additional guidance or a safe harbor may unnecessarily limit issuers' methods to determine a reasonable estimate, or inadvertently create a *de facto* standard. While providing this flexibility, we note that the issuer would be required to maintain documentation of the determination of that reasonable estimate and provide such documentation to the relevant exchange.[239]

The final rules provide that erroneously awarded compensation must be calculated without respect to tax liabilities that may have been incurred or paid by the executive[240] to ensure that the issuer 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 permits the issuer to avoid the burden and administrative costs associated with calculating erroneously awarded compensation based on the particular tax circumstances of individual executive officers, which may vary significantly based on factors independent of the incentive-based compensation and outside of the issuer's control. While we acknowledge the views of the commenters who opposed a pre-tax basis for recovery, we are adopting such an approach because it better effectuates the statutory intent of Section 10D in that it seeks to ensure recovery

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[239] *See* Rule 10D-1(b)(1)(iii)(B). We disagree with commenters that recommended that the documentation of the determination be provided to the exchanges only upon request. Requiring the documentation in all cases will provide exchanges ready access to the necessary documentation to evaluate when they seek to determine whether estimates were reasonable. Requiring such documentation only upon request would put the onus of seeking documentation on the exchanges, adding an additional burden to enforcing the requirements that could lead to some issuers conducting a less robust—or even no—analysis in the belief that their analysis is unlikely to be reviewed or questioned.

[240] Rule 10D-1(b)(1)(iii) provides that the erroneously awarded compensation must be computed without regard to any taxes paid by the executive officer.

for the benefit of shareholders of the full amount of erroneously awarded compensation paid to the executive.[241]

The ability of executive officers to recoup, to the extent authorized by applicable tax laws and regulations, taxes previously paid on recovered compensation, would mitigate fairness concerns raised by commenters.[242] We note, however, that the extent to which a tax system allows current adjustments for tax paid in prior periods under assumptions that later prove incorrect is a matter of tax policy outside the scope of this rulemaking. Limiting recovery to after-tax amounts would in effect require shareholders to provide the tax relief that the tax authorities in the executive officer's jurisdiction chose not to offer. In any event, we believe any resulting tax burden should be borne by executive officers, not the issuer and its shareholders. In light of these considerations, coupled with the administrative difficulty for issuers to implement recovery on an after-tax basis, we believe the approach reflected in the final rules better meets the goal of recovery of the full amount of erroneously awarded compensation paid to the executive.

We intend for the definition of erroneously awarded compensation to apply in a principles-based manner and as a result issuers may adopt more extensive recovery policies, so long as those policies at a minimum satisfy the requirements of the rule. While the definition is principles-based, we believe some guidance will be helpful for issuers, consistent with the proposal and input from commenters.

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241 *See* Senate Report *supra* note 5.

242 We are aware that in some instances executive officers may be able to reduce their current-period taxes to reflect earlier tax payments made on compensation that is subsequently recovered.

- For cash awards, the erroneously awarded compensation is 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.[243]
- For cash awards paid from bonus pools, the erroneously awarded compensation is the *pro rata* portion of any deficiency that results from the aggregate bonus pool that is reduced based on applying the restated financial reporting measure.[244]
- For equity awards, if the shares, options, or SARs are still held at the time of recovery, the erroneously awarded compensation is the number of such securities received in excess of the number that should have been received applying the restated financial reporting measure (or the value of that excess number). If the options or SARs have been exercised, but the underlying shares have not been sold, the erroneously awarded compensation is the number of shares underlying the excess options or SARs (or the value thereof).

While we acknowledge that many commenters sought additional guidance, we decline to offer more specific guidance regarding the determination of erroneously awarded compensation with respect to additional forms of incentive-based compensation, as the determination will depend on the particular facts and circumstances applicable to that issuer and the executive officer's

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[243] Similarly, for nonqualified deferred compensation, the executive officer's account balance or distributions would be reduced by the erroneously awarded compensation contributed to the nonqualified deferred compensation plan and the interest or other earnings accrued thereon under the nonqualified deferred compensation plan.

[244] Boards also may not 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. For example, 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, each bonus would need to be ratably reduced to recover the excess amount for each individual's bonus.

particular compensation arrangement. Issuers and their boards will be in the best position to make these determinations. A principles-based application of the rules provides useful flexibility for issuers and boards, and avoids the risk that more detailed guidance may inadvertently establish *de facto* standards. In that regard, boards of directors should consider the statute's goal to return erroneously awarded compensation to the issuer and its shareholders, and their fiduciary duties to those shareholders, in making such determinations. We additionally note that, as described in Section II.D., the issuer is required to disclose the amount of erroneously awarded compensation attributable to an accounting restatement, including an analysis of how the erroneously awarded compensation was calculated.

In response to commenters who raised concerns that the rule may result in duplicative recovery, we note that Rule 10D-1 is not intended to alter or otherwise affect the interpretation of other recovery provisions, such as Sarbanes-Oxley Act Section 304, or the determination by the Commission or the courts of when reimbursement is required under Section 304. To the extent that the application of Rule 10D-1 would provide for recovery of incentive-based compensation that the issuer recovers pursuant to Section 304 or other recovery obligations, it would be appropriate for the amount the executive officer has already reimbursed the issuer to be credited to the required recovery under the issuer's Rule 10D-1 recovery policy.[245] We note, however, that recovery under Rule 10D-1 would not preclude recovery under Sarbanes-Oxley Act Section 304, to the extent any applicable amounts have not been reimbursed to the issuer.

b. Board Discretion Regarding Whether to Seek Recovery

Section 10D requires the Commission, by rule, to direct the exchanges and associations

[245] Similarly, to the extent that the erroneously awarded compensation is recovered under a foreign recovery regime, the recovery would meet the obligations of Rule 10D-1.

to adopt listing standards that require issuers to adopt and comply with recovery policies. Specifically, under the statute, the Commission's rules shall require each issuer to develop a policy providing 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.

i. Proposed Amendments

The Commission proposed 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 where certain conditions are met, including that (i) the direct expense paid to a third party to assist in enforcing the policy would exceed the amount to be recovered, and (ii) in certain circumstances where the recovery would violate home country law that was in effect prior to the date of publication of the Proposing Release in the Federal Register. As proposed, before concluding that it would be impracticable to recover any amount of erroneously awarded compensation based on direct expenses paid to a third party, the issuer would first need to make a reasonable attempt to recover that incentive-based compensation, document its attempts to recover, and provide that documentation to the exchange. 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 exchange, that recovery would result in such a violation. In addition, to minimize any incentive countries may have to change their laws in response to this provision, as proposed, the relevant home country law must have been adopted prior to the date of publication in the Federal Register of proposed Rule 10D-1, which was July 14, 2015. In either case, 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, or in the absence of a compensation committee, by a majority of the independent directors serving on the board.

ii. Comments

We received mixed comments regarding the board's discretion over whether to pursue recovery and the scope of any such discretion. Some commenters expressly supported the proposal to provide limited board discretion over whether to pursue recovery, including the proposed conditions.[246] A few commenters specifically supported the proposal to require that the individuals exercising discretion should be independent directors.[247] Other commenters expressed concern that the proposed level of discretion was excessive.[248]

In contrast, other commenters expressed concern regarding the limited scope of proposed board discretion[249] and the requirement to first make a "reasonable attempt" at recovery before exercising discretion.[250] Some of these recommended a *de minimis* threshold for pursuing

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246 *See* comment letters from CII 1; OPERS 1; and UAW, *et al*.

247 *See* comment letters from ABA 1; and NACD.

248 *See, e.g.,* comment letters from AFL-CIO (suggesting that the statutory language that the issuer "will recover" indicates that the board should have no discretion); As You Sow 1 (recommending limiting consideration of costs to direct costs and expressing concern that issuers may be incentivized to inflate costs to avoid recovery); Better Markets 1; CalPERS 1 (recommending that erroneously awarded compensation be recovered even where the costs of recovery are greater than the amount recovered); and Public Citizen 1. *See also* comment letter from Fried (suggesting that boards may use discretion to decide not to recover and that requiring boards to recover excess pay, even if it is costly to do so, may reduce both executives' resistance to returning erroneously awarded pay and the likelihood of the need for recovery).

249 *See, e.g.,* comment letters from ABA 1 (characterizing the limited scope of board discretion as "the single biggest impediment to the effective implementation of Section 10D"); BRT 1; Bishop; Compensation Advisory Partners LLC ("CAP"); CCMC 1; CEC 1; CFA Institute 1; Chevron; Coalition; Compensia; Davis Polk 1; Duane; Ensco; Exxon; FedEx 1; FSR; Hay Group; IBC; Kovachev; Mercer; NACD; Pearl Meyer; S&C 1; SCG 1; TCA; TELUS; and WAW. *See also* comment letters in response to the Reopening Release from ABA 2; CEC 2; Davis Polk 3; ICGN; McGuireWoods; and Hunton.

250 *See, e.g.,* comment letters from ABA 1 (noting the subjective nature of the determination and the resulting compliance burden, and recommending against the requirement); CEC 1; Chevron; Compensia (suggesting the requirement is an unreasonable and impractical burden); Exxon; IBC; Hay Group; SCG 1; and TELUS. Some of these commenters sought guidance as to what constitutes a reasonable attempt at recovery and requested the

recovery,[251] or specifically objected to limiting cost considerations to direct costs.[252] Some commenters further recommended that directors should have discretion to determine whether to recover awards based on metrics that cannot be accurately recalculated, including stock price and TSR.[253] Other commenters further contended that directors' state law fiduciary duties justify allowing boards to exercise greater discretion, noting the board's business judgment, or expressing concern that the proposal's restricted discretion would diminish board authority.[254] Some commenters recommended that the Commission could balance greater board discretion with a requirement to publicly disclose the determination not to recover, the reasons why, and the amount at issue.[255] Commenters also identified other specific factors that boards should be

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Commission provide examples or a safe harbor. *See* comment letters from CEC 1 (recommending the Commission permit the board to make a preliminary determination of the success of the reasonable attempt); Chevron; and Hay Group.

[251] *See, e.g.,* comment letters from ABA 1 (recommending a $10,000 threshold per executive); Chevron; Compensia; Duane (recommending a $50,000 threshold per executive); FSR; and Mercer (recommending a $10,000 threshold per executive).

[252] *See, e.g.,* comment letters from ABA 1 (recommending that the board be permitted to consider the expense of determining whether excess compensation resulted from the restatement along with the recovery costs); CEC 1 (recommending that the Commission permit consideration of specific indirect costs, such as opportunity costs resulting from diverting internal staff, management and board resources); Compensia; Duane; SCG 1; and TELUS (recommending that the board be permitted to consider the costs of determining what the recoverable amount would be rather than incur those costs before making its determination). *See also* comment letter in response to the Reopening Release from ABA 2 (recommending the impracticability analysis be based on direct costs, whether or not paid to a third party, as well as any indirect costs that it can reasonably allocate to the recovery process).

[253] *See, e.g.,* comment letters from Davis Polk 1; and SH&P.

[254] *See, e.g.,* comment letters from BRT 1 (suggesting that directors have fiduciary duties, which would serve to blunt any potential adverse impact to Section 10D); Bishop; CCMC 1; Compensia (citing board's fiduciary duties and noting that shareholders could vote against directors or sue for breach of fiduciary duty); Kovachev (suggesting that under state corporate law directors, not shareholders or the Federal government, are responsible for determining executive compensation); Pearl Meyer; SCG 1 (suggesting that deciding whether excess compensation should be recovered is not unlike other decisions the compensation committee regularly makes); and WAW. *See also* comment letters in response to the Reopening Release from CEC 2 (suggesting that without sufficient discretion the rule could force a board to carry out a recovery in a manner at odds with its fiduciary duties and result in shareholder harm); and Hunton (noting discretion is consistent with the board's fiduciary or other legal duties under state law).

[255] *See* comment letters from CFA Institute 1; S&C 1; and TCA.

permitted to take into account in deciding whether to recover, such as the probability of recovery or likelihood of success;[256] the circumstances giving rise to the accounting restatement;[257] the potential costs of determining and defending the recovery determination;[258] the potential effects on the issuer;[259] the potential effect on executive officers;[260] and the long-term impact on the issuer.[261]

Commenters addressing the impracticability conclusion based on violations of home country law expressed concern with the proposed limitations,[262] with some suggesting that limiting the impracticability exclusion to home country law in effect as of the proposal's Federal Register publication could intrude into the public policy determinations of other nations[263] and create a disincentive for foreign firms to list in the U.S.[264] Some commenters also expressed

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256 *See* comment letters from BRT 1; and Bishop.

257 *See, e.g.,* comment letters from BRT 1 (suggesting taking into account the scope of misconduct or responsibility for the errors); CFA Institute 1 (suggesting taking into account the severity of the error behind the original financial reporting decision); and Davis Polk 1 (suggesting taking into account culpability).

258 *See* comment letters from Bishop; and Davis Polk 1. *See also* comment letters from Ensco; and Pearl Meyer (recommending consideration be given where executives are subject to pre-existing legally binding contracts).

259 *See, e.g.,* comment letters from Bishop; BRT 1; Davis Polk 1; NACD; and S&C 1 (expressing concern over negative publicity or reputational harm to the issuer). *See also* comment letter from Davis Polk 1 (noting that recovery could be considered an admission against interest by the issuer resulting in higher litigation risk).

260 *See* comment letters from Davis Polk 1 (recommending permitting consideration of severe financial hardship, death or serious illness of the executive); and S&C 1 (recommending permitting consideration of the effect on recruiting and retaining executives).

261 *See* comment letters from BRT 1; and S&C 1.

262 *See, e.g.,* comment letters from ABA 1; Bishop; CCMC 1; Coalition; Duane; Exxon; FSR; Kaye Scholer; Mercer; Osler; SAP; S&C 1; TELUS; and UBS. Some commenters recommended that an exemption based on home country law should also cover any other countries whose laws otherwise apply to the executive officer, such as the local law of the jurisdiction where the executive officer is employed, as that local law would govern the employee/employer relationship. *See, e.g.,* comment letters from ABA 1; CCMC 1; Coalition; Davis Polk 1; Exxon; FSR; Kaye Scholer; Osler; SAP; S&C 1; TELUS; and UBS. *See also* comment letter in response to the Reopening Release from Hunton.

263 *See* comment letters from S&C 1; and TELUS.

264 *See* comment letters from CCMC 1; and Coalition. *See also* comment letters in response to the Reopening Release from Cravath; and CCMC 2 (suggesting that the rules may penalize foreign firms for changes in law made after adoption of the rules).

concern over the proposed requirement for a legal opinion.[265] However, no commenters identified any foreign laws that would prohibit recovery under the proposed rules.

Several commenters expressed concern that the proposal did not address potential impediments to recovery under state law and questioned whether the listing standards adopted pursuant to this rule would preempt state laws governing compensation.[266] A number of these commenters suggested that the Commission provide an exception to recovery or allow boards discretion not to pursue recovery where such actions may cause the issuer to violate state law.[267]

Additionally, some commenters expressed concern regarding recovery of amounts deferred under tax-qualified retirement plans, stating that such actions may violate ERISA anti-alienation rules, which could result in loss of tax-qualified status for the plan.[268]

iii. Final Amendments

After considering the views of commenters, we are adopting substantially as proposed rules to require 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. We read the Section 10D recovery mandate to require recovery regardless of "fault" or responsibility for the error or resulting restatement. The language of this provision signals that the issuer should pursue recovery in most instances.

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[265] *See, e.g.,* comment letters from Bishop; CEC 1 (noting legal uncertainty in some jurisdictions); CCMC 1; Coalition; Freshfields; SAP; S&C 1 (noting absence of a prohibition does not mean the compensation recovery provision would be enforced); and TELUS (noting enforceability of compensation recovery arrangements is a developing area of jurisprudence).

[266] *See* comment letters from ABA 1; American Vanguard; Bishop; Coalition; Compensia; Cooley; Exxon; FSR; Mercer; NACD; Pearl Meyer; and SCG 1.

[267] *See* comment letters from Compensia; Cooley; FSR; Pearl Meyer; and SCG 1.

[268] *See, e.g.,* comment letters from ABA 1; IBC; and Sutherland (noting that violating the Internal Revenue Code could result in loss of tax-qualified status for the plan, causing adverse consequences to all participants). *See also* comment letter from the Reopening Release from McGuireWoods.

As we have previously noted, the intent of Section 10D is to require executive officers to return monies that rightfully belong to the issuer and its shareholders. In keeping with this intent and our understanding that the statute contemplates recovery in most instances, we have determined to establish very limited circumstances that would allow executive officers, or permit boards of directors to allow executive officers, to retain incentive-based compensation that they were erroneously awarded.

Some commenters sought to justify allowing boards to exercise greater discretion or permitting issuers to not seek to recover erroneously awarded compensation by citing to state law fiduciary duties and a board's business judgment.[269] Commenters also suggested that the Commission could balance greater board discretion with additional disclosure or suggested that boards should be permitted to take into account the probability of recovery or likelihood of success, the circumstances giving rise to the accounting restatement, the potential costs of determining and defending the recovery determination, the potential effects on the issuer, the potential effect on executive officers, and the long-term impact on the issuer. We have considered the potential costs of not affording such discretion, such as the possibility that in some instances recovery would be required even if the total costs for the issuer exceed the expected recovery amount. Notwithstanding these possible costs, other than the limited exceptions noted below, we do not believe that additional discretion to forgo recovery of erroneously awarded compensation would be appropriate. In enacting Section 10D, Congress determined that listed companies in the U.S. should "develop and implement" a policy providing that they "will recover" erroneously awarded compensation within three years of an accounting restatement. Congress chose to impose a federally mandated policy with specific parameters and

[269] *See supra* note 254.

requirements. Its decision to adopt such a mandate implies that Congress concluded that issuers likely would not voluntarily pursue recovery to the extent mandated by Section 10D. Allowing issuers broad discretion to decide whether to enforce such policies would therefore tend to undermine Congress' intent, as issuers that have previously failed to adopt recovery policies that Congress concluded would protect shareholders may also tend to exercise their discretion to recover in ways that similarly fail to protect shareholders. Thus, to the extent that commenters' suggestions would further permit executive officers to retain monies that they should not have been awarded pursuant to their compensation agreements, such exceptions or limitations could undermine the objectives of the statute.

The exceptions we adopt below will limit the instances in which an issuer would be obliged to pursue a money-losing recovery. Providing for such narrow exceptions is consistent with the overall structure of the statutory recovery mandate, which is unqualified and applies on a no-fault basis to erroneously awarded compensation. We are concerned that affording broader discretion could undermine the effectiveness of the rule, as issuers and their boards may face short-term incentives or other impediments to pursuing recovery even where recovery would be in the interest of shareholders, the long-term interest of the issuer, or the market as a whole. In addition, providing boards with broad discretion to waive recovery could also reduce the reliability of financial reporting, as executive officers may expect that they would be enriched by some errors if the board had broad discretion.

After considering the views of commenters, we are adopting impracticability exceptions, as proposed, where (1) the direct cost of recovery would exceed the amount of recovery, and (2)

the recovery would violate home country law and additional conditions are met.[270] We are additionally adopting an exception, as discussed further below, that addresses commenters' concerns about the implications of recovering amounts from tax-qualified retirement plans.

We do not believe that inconsistency between the rules and existing compensation contracts, in itself, should be a basis for finding recovery to be impracticable. Such an approach could effectively exclude a significant number of existing compensation contracts from the scope of the rule, undermining its effectiveness. We note that issuers have been on notice of the statutory mandate for several years and will have additional time between adoption of these rules and exchange listing standards implementing the rules to amend any contracts to accommodate recovery. While a number of commenters suggested that recovery should be limited to executive officers who bear responsibility for the error; as discussed in Section II.C.1.c, under our reading of the statute, the extent to which an individual executive officer may be responsible for the financial statement errors requiring the restatement is irrelevant to whether they are subject to the requirement or the issuer should seek recovery.[271] We also note that a number of commenters recommended a *de minimis* threshold for pursuing recovery. However, absent satisfaction of the conditions to demonstrate that recovery is impracticable due to costs, we believe a *de minimis* exception may risk being both over and under-inclusive, given the variation in issuer sizes and executive compensation structures. We therefore decline to adopt such an approach.

In determining whether recovery would be impracticable due to costs, the only permissible criteria under the rule are whether the direct costs paid to a third party to assist in

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[270] *See* 17 CFR 240.10D-1(b)(1)(iv)(A) ("Rule 10D-1(b)(1)(iv)(A)") and 17 CFR 240.10D-1(b)(1)(iv)(B) ("Rule 10D-1(b)(1)(iv)(B)").

[271] We note that this standard similarly applies in Sarbanes-Oxley Act Section 304.

enforcing recovery would exceed the erroneously awarded compensation amounts.[272] Only direct costs paid to a third party, such as reasonable legal expenses and consulting fees, may be considered for this purpose.[273] We disagree with those commenters that recommended permitting issuers to include indirect costs. Indirect costs relating to concerns such as reputation or the effect on hiring new executive officers are not readily quantifiable and, as one commenter noted, are susceptible to exaggeration,[274] in addition to other confounding factors. We therefore do not believe such costs should be taken into account when determining whether recovery is impracticable.

The final rules also require the issuer to make a reasonable attempt to recover incentive-based compensation before concluding that it would be impracticable to do so. The issuer must document its attempts to recover and provide that documentation to the exchange.[275] We remain concerned that, without a requirement to attempt recovery, an issuer could simply assert impracticability without doing the work necessary to establish that the costs exceed the recovery amounts. We believe that requiring an attempt to recover is 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.

In providing this narrow cost exception, we note that Section 10D provides that, to meet the applicable listing standard, the issuer "will recover," without exceptions, erroneously

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272 *See* Rule 10D-1(b)(1)(iv)(A).

273 We note that the challenges of using incentive-based compensation tied to stock price and TSR to determine the amount of compensation to be recovered are not a sufficient basis for determining that recovery is impracticable. Nonetheless, the amount spent on a consultant or other third-party service provider could be considered in determining whether the impracticability exception applies, once the recoverable amount is determined.

274 *See* comment letter from As You Sow 1.

275 *See* Rule 10D-1(b)(1)(iv)(A). New Item 402(w) of Regulation S-K also requires the issuer to disclose why it determined not to pursue recovery.

awarded compensation resulting from material misstatements of financial reporting items. The plain text does not provide for issuer discretion. We believe that Congress' broad mandate to recover signals that an exception from recovery of an executive officer's erroneously awarded compensation, if any, that the Commission exercises its authority to grant should be carefully considered and tailored. In exercising our authority to provide an exception, we have determined that issuers should not be afforded broad discretion to determine whether to recover compensation. We are therefore adopting as proposed a narrow exception relating to impracticability due to costs.

We also believe it is appropriate to adopt substantially as proposed a narrow exception that allows an issuer to conclude that recovery is impracticable because it would violate the home country law of the issuer.[276] 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 [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER], the date of publication in the *Federal Register* of Rule 10D-1.[277] Before concluding that it would be impracticable to recover because doing so would violate home country law in effect as of the date of publication of Rule 10D-1 in the *Federal Register*, the issuer would first need to obtain an opinion of home country counsel, acceptable to the applicable exchange, that recovery would result in such a violation.[278]

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[276] *See* Rule 10D-1(b)(1)(iv)(B).

[277] As discussed further below, in a modification from the Proposing Release, the relevant home country law must have been adopted prior to the date of publication in the Federal Register of Rule 10D-1 rather than July 14, 2015, which was the date of publication of the proposed rule.

[278] *See* Rule 10D-1(b)(1)(iv)(B). The issuer must provide such opinion to the exchange. We recognize the concerns of some commenters regarding the requirement for a legal opinion. We note, however, that requiring an issuer to obtain a legal opinion provides additional substantiation to the issuer's claim that recovery would result in such a violation and reduces the burden on exchanges, who might otherwise have to make a determination of whether the exception is available to the issuer, by permitting them to use and rely on the opinion.

We recognize some commenters' concerns that the erroneously awarded compensation rules could intrude into the public policy determinations of other nations or create a disincentive for foreign firms to list in the U.S. However, the recovery mandate of Section 10D signals that the issuer should generally pursue recovery when it is determined there is erroneously awarded compensation subject to the rule. Issuers that choose to list on U.S. exchanges have chosen to be subject to the rules of those exchanges and the laws of the United States. Such issuers may choose to list on U.S. exchanges in order to signal the greater reliability of their financial reporting, and making executive officers subject to recovery may further strengthen this signal, so that the adopted approach in fact may incentivize, rather than discourage, listings by foreign firms. Given the clear mandate from the statute that executive officers not be permitted to retain erroneously awarded compensation, we have determined that any exception relating to impracticability due to conflict with home country law should be narrow.

We are not expanding the exception, as suggested by some commenters, to cover the domicile of the executive officer or any other country whose laws may apply to the executive officer or to encompass foreign laws that may be enacted in the future.[279] As compared to the jurisdiction of incorporation, it may be easier for an executive officer to shift domicile or work location and thereby avoid application of the rule. To the extent that the laws of jurisdictions other than the issuer's place of incorporation would present obstacles to recovery, we think those obstacles are more appropriately addressed by the discretion we are providing not to pursue recovery in situations in which the direct costs of recovering the erroneously awarded compensation would exceed the amount to be recovered.

[279] *See supra* note 262.

Similarly we do not believe it is appropriate for the exception to apply without a time limitation. Doing so could incentivize jurisdictions to enact statutes that prohibit or restrict recovery in an effort to attract issuers that may be seeking to avoid enforcement of a compensation recovery policy. Although we are not aware that any such laws have been adopted since publication of the proposed rule, and mindful of the length of time that has passed since 2015, in a modification from the proposal, the relevant home country law must have been adopted prior to the date of publication in the Federal Register of Rule 10D-1 rather than July 14, 2015, which was the date of publication of the proposed rule. This change will avoid any undue disruption for foreign issuers who may have entered the U.S. markets and listed on an exchange not anticipating a potential conflict with the final amendments and would now face an immediate decision about whether to maintain their U.S. listing. Going forward, however, we believe it is appropriate and consistent with the purposes of Section 10D to require foreign issuers that avail themselves of the benefits of U.S. listing to comply with the mandatory recovery policy in the same manner as domestic issuers.

We also decline to provide an exception or additional board discretion not to pursue recovery due to potential state law conflicts. As a threshold matter, a number of commenters asserted that it is unclear whether the mandated recovery would be in violation of any state laws. We are not aware of any state law that currently would clearly prohibit recovery, and commenters did not identify any.[280] We recognize that executive officers seeking to oppose recovery could assert a number of defenses, including objections based on state law, and issuers

[280] As an example of a potentially conflicting state law, one commenter cited California Labor Code Section 221, which provides that it is "unlawful for any employer to collect or receive from an employee any part of wages theretofore paid by said employer to said employee." *See* comment letter from Bishop. California Labor Code Section 224, however, also provides that Section 221 "shall in no way make it unlawful for an employer to withhold or divert any portion of an employee's wages when the employer is required or empowered so to do by state or Federal law."

may need to address such matters as part of the recovery process. Nevertheless, for the reasons discussed above, we believe issuers should have discretion not to pursue recovery only in the limited circumstances outlined in the final rule.

In any event, we believe that state law will not pose a significant obstacle to recovery because issuers should have strong arguments that state laws that conflict with Section 10D are preempted. With respect to preemption, as a general matter, listing standards adopted by national securities exchanges and associations at the direction of Congress and the Commission can preempt state laws in certain circumstances.[281] In such a case, a court may consider whether a state law that prevents or interferes with the recovery required under this rule "stands as an obstacle" to accomplishing the objectives of Federal law.[282] As discussed above, this rule will advance the objectives of Section 10D by ensuring recovery from all listed issuers for the benefit of shareholders of erroneously awarded compensation that would not have been paid had the issuer's financial statements not been in error. The recovery requirement would serve the interest of fairness to shareholders and improve the overall quality and reliability of financial reporting, which further benefits shareholders and the capital markets as a whole. Accordingly, issuers should be able to assert that state laws that would prevent or impede recovery are preempted, although the outcomes for any particular state law would depend on the details of that provision.

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[281] *See Credit Suisse First Bos. Corp. v. Grunwald*, 400 F.3d 1119, 1128 (9th Cir. 2005).

[282] *See id. See also Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 873 (2000) (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)). Some commenters argue that because Section 10D is addressed to exchanges and associations, state law would not be preempted because it is technically possible for an issuer to comply with both state and Federal law. This describes one type of implied preemption—"conflict preemption." *Id.* at 873–74. But a different type of implied preemption—"obstacle preemption"—may arise where a state law stands as an obstacle to Federal law. *See, e.g.*, *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 342-43, 352 (2011) (finding no conflict but ruling that state law was preempted as an obstacle to a Federal scheme); and *Williamson v. Mazda Motors of Am.*, 562 U.S. 323, 330 (2011).

In exercising our discretion to provide an exception for tax-qualified retirement plans described in 26 U.S.C. 401(a), we have determined that a narrow exception is appropriate. Under 26 U.S.C. 401(a)(13), a plan will not be tax-qualified unless it provides that the plan's benefits may not be assigned or alienated, subject to certain limited exceptions that are not applicable here. Commenters noted that this statutory anti-alienation rule would preclude a tax-qualified plan from complying with a request for recovery. Commenters also expressed concerns that requiring recovery of amounts deferred under tax-qualified retirement plans may cause plans to violate the anti-alienation rule and other plan qualification requirements under the Internal Revenue Code. In recognition of those concerns, the final rule will permit issuers to forgo recovery from tax-qualified retirement plans.[283] Without this exception, such plans may fail statutory requirements for tax exemption, resulting in potentially adverse tax consequences for all plan participants. Thus, the change would avoid serious potential tax consequences for rank-and-file employees by providing a narrow exemption from recovery for a limited amount of incentive-based compensation.[284] Erroneously awarded incentive-based compensation

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[283] *See* Rule 10D-1(b)(iv)(C). One of these commenters noted that tax-qualified retirement plans are required to be non-discriminatory in application and, thus, are not incentive-based compensation and are not subject to various "incentive plan" disclosure under Item 402. *See* comment letter from ABA 1. *See also* comment letter from Sutherland (also noting that tax-qualified retirement plans are not considered incentive-based compensation in the normal sense of that term). This commenter suggested that the Commission not interpret "incentive-based compensation" to include either tax-qualified or non-qualified plans, further suggesting that all such compensation is provided for retirement, rather than as a performance incentive. Because amounts contributed to qualified plans may be affected by incentive-based awards, such as in the case where the benefit formula for a plan includes amounts awarded as an annual bonus, we disagree with this commenter's characterization of such compensation as categorically lacking a performance incentive.

[284] We anticipate the effect will be modest. We believe that incentive-based compensation will typically have only small and indirect effects on amounts added to tax-qualified retirement plans. 26 U.S.C. 401(a)(17) precludes a tax-qualified retirement plan from basing contributions or benefits on compensation in excess of an annual limit ($305,000 in 2022). The compensation of many covered executive officers will exceed this limit regardless of any incentive-based compensation they may have been erroneously awarded. In addition, 26 U.S.C. 415 provides a series of limits on benefits under qualified defined benefit plans and on contributions and other additions under qualified defined contribution plans. For example, under these limitations, in 2022, annual additions with respect to a participant in a defined contribution plan may not exceed $61,000 and a participant's annual benefit under a defined benefit plan may not exceed $245,000.

contributed to plans limited only to executive officers, SERPs, or other nonqualified plans and benefits therefrom, would still be subject to recovery.

In order to mitigate potential conflicts of interest, any determination that recovery would be impracticable in any of these three circumstances must be made by the issuer's committee of independent directors that is responsible for executive compensation decisions. In the absence of a compensation committee, the determination must be made by a majority of the independent directors serving on the board. Such a determination, as with all determinations under Rule 10D-1, is subject to review by the listing exchange.

We acknowledge that there are circumstances in which pursuing recovery of erroneously awarded compensation may not be in the interest of shareholders. We have determined that limited board discretion to determine when it would be impracticable to recover is necessary or appropriate in the public interest and consistent with the protection of investors. Permitting board discretion in these circumstances will save issuers the expense of pursuing recovery in circumstances where recovery would violate anti-alienation rules applicable to tax-qualified retirement plans, or home country law, or where the direct costs of recovery could exceed or be disproportionate to the erroneously awarded compensation amounts. Balancing these concerns, the standard we are adopting appropriately permits boards of directors to evaluate whether to pursue recovery of erroneously awarded compensation, but only in these limited circumstances.

c. Board Discretion Regarding the Means 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.

i. Proposed Amendments

In the Proposing Release, in addition to addressing board discretion regarding whether to recover excess incentive-based compensation, the Commission addressed whether boards may exercise discretion in effecting the means of recovery. The Proposing Release recognized that the appropriate means of recovery may vary by issuer and by type of compensation arrangement, and that consequently issuers should be able to exercise discretion in how to accomplish recovery. Regardless of the means of recovery utilized, the Proposing Release indicated that issuers should recover excess incentive-based compensation reasonably promptly, as undue delay would constitute noncompliance with an issuer's recovery policy.

ii. Comments

We received various comments on the Proposing Release relating to whether boards may exercise discretion regarding the means of recovery.

Commenters generally supported allowing board discretion regarding the means of recovery.[285] Some commenters noted the concept of fungibility of assets, which would permit issuers to more readily recover erroneously awarded compensation.[286] Based on this concept of fungibility, commenters recommended permitting issuers various means of recovery, such as through canceling unrelated unvested compensation awards,[287] offsets against nonqualified deferred compensation and unpaid incentive compensation,[288] future compensation

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[285] *See* comment letters from ABA 1; Bishop; CEC 1; Compensia; Exxon; and FSR. *See also* comment letters in response to the Reopening Release from CEC 2; McGuireWoods (recommending flexibility for boards to enter into settlement and repayment terms); and Hunton.

[286] *See* comment letters from AFL-CIO; and Exxon.

[287] *See* comment letters from ABA 1; CEC 1; and WAW.

[288] *See* comment letters from Exxon; and WAW.

obligations,[289] or dividends on company stock owed to an executive officer.[290] Some commenters also recommended including in the final rule specific instructions on how to compute the excess amount of specific forms of incentive-based compensation and sought discretion to recover the cash value of excess shares subject to recovery.[291]

Commenters also recommended that the final rules permit, or that the Commission provide guidance or other confirmation relating to the use of, nonqualified deferred compensation plans, holdback policies, or otherwise deferring payment of incentive-based compensation to facilitate potential future recovery.[292] Other commenters highlighted potential benefits to such set-offs.[293] Some commenters additionally recommended that netting overpayments with incentive-based compensation underpayments resulting from restating financial statements for different periods be permitted under the rules.[294]

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289 *See* comment letters from Duane; and WAW.

290 *See* comment letter from Exxon.

291 *See, e.g.,* comment letters from ABA 1 (recommending that, for equity awards, recovery should first be sought from shares that remain held, and that for the equity awards where the shares were sold prior to recovery that the recovery be for the fair market value on the date the erroneously awarded compensation amount is determined, or if the shares were gifted, the fair market value on the date of the gift); Duane (noting potential restrictions on an executive's ability to liquidate securities and issuers' stock retention requirements, and recommending recovery of stock awards either in cash or in kind over reasonable periods of time); Exxon (recommending cash value should be calculated at the time the shares are "received" within the meaning of the rule to avoid incentivizing executives to sell shares immediately on vesting); and FSR (recommending basing the cash amount on the shares' value on the date the issuer is required to prepare a restatement to address manipulation concerns).

292 *See, e.g.,* comment letters from ABA 1; AFL-CIO; Compensia; and NACD.

293 *See, e.g.,* comment letters from Exxon (enhancing the ability to recover promptly); CEC 1 (ease of recovery and ability to recover the full pre-tax amount of excess compensation); and WAW (reduced cost of recovery and risk of litigation with executives).

294 *See, e.g.,* comment letters from ABA 1; Bishop; CEC 1 (recommending disclosure to inform shareholders of recovery by netting); Compensia; Mercer (suggesting that without netting executives would be penalized and that making the executive whole could distort the pay for performance relationship); NACD; SCG 1; and SH&P. Two of these commenters suggested that this approach would be fair and consistent with the "no-fault" standard of the proposed rule. *See* comment letters from NACD; and SH&P.

We also received varied comments regarding the timing requirements for recovery ranging from recommendations to require "immediate recovery,"[295] input regarding the meaning of the "reasonably promptly" guidance,[296] and recommendations opposing time limits.[297] Some commenters recommended allowing deferred repayments,[298] with one noting that immediate recovery could result in significant economic hardship to an executive officer and that a deferred payment plan could increase the likelihood of collecting and avoid potential litigation costs.[299]

iii. Final Amendments

After considering the views of commenters, we continue to believe that the adopted rules should provide boards discretion, subject to certain reasonable restrictions, regarding the means of recovery and are providing the following guidance to assist boards in exercising that discretion.[300] Rule 10D-1 does not limit the amount of compensation the board is required to recover; however, the rule does not permit boards to settle for less than the full recovery amount unless they satisfy the conditions that demonstrate recovery is impracticable.[301]

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295 *See* comment letter from CalPERS 1.

296 *See* comment letter from Better Markets 1 (further recommending requiring an explanation of the timing to discourage a protracted recovery process).

297 *See, e.g.,* comment letters from Bishop (noting that issuers will face circumstances beyond their control, such as litigation by executives); CFA Institute 1 (recommending that the listing exchange determine whether an issuer is complying with its recovery policy); and NACD.

298 *See, e.g.,* comment letters ABA 1 (noting that there may be circumstances where the executive is otherwise unable to repay the excess amount); Bishop; Davis Polk 1; Ensco; and SCG 1 (recommending that the rule permit discretion where the board determines enforcement could affect the issuer's defense in a securities class action). One of these commenters sought clarification that repayment plans would not constitute prohibited personal loans under Exchange Act Section 13(k). *See* comment letter from Bishop. *See also* comment letters in response to the Reopening Release from ABA 2 (recommending discretion to permit a deferred payment plan); McGuireWoods (recommending flexibility for boards to enter into settlement and repayment terms); and Hunton.

299 *See* comment letter from Davis Polk 1.

300 *See* Rule 10D-1(b)(1)(iii). For a discussion of how to determine the amounts, *see supra* note 235.

301 In that circumstance, the same conditions would apply as for a determination to forgo recovery. *See* Section II.C.3.b.

We recognize that the appropriate means of recovery may vary by issuer and by type of compensation arrangement. We agree with commenters that many different means of recovery may be appropriate in different circumstances. Consequently, the final amendments permit issuers to exercise discretion in how to accomplish recovery. Nevertheless, in exercising this discretion, issuers should act in a manner that effectuates the purpose of the statute: to prevent current or former executive officers from retaining compensation that they received and to which they were not entitled under the issuer's restated financial results.

Regardless of the means of recovery used, issuers should recover erroneously awarded compensation reasonably promptly, because delays in recovering excess payments allow executive officers to capture the time value of money with respect to funds they did not earn, which should instead belong to shareholders. Consistent with the discussion of the timing in which the issuer must seek recovery in the Proposing Release, the final rule clarifies that the issuer must pursue recovery "reasonably promptly."[302] The rule does not, however, adopt a definition of "reasonably promptly." We recognize that what is reasonable may depend on the additional cost incident to recovery efforts. We expect that issuers and their directors and officers, in the exercise of their fiduciary duty to safeguard the assets of the issuer (including the time value of any potentially recoverable compensation), will pursue the most appropriate balance of cost and speed in determining the appropriate means to seek recovery. Furthermore, the rules do not prevent an issuer from securing recovery through means that are appropriate based on the particular facts and circumstances of each executive officer that owes a recoverable amount.[303]

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[302] *See* Rule 10D-1(b)(1).

[303] We note that unpaid amounts will be subject to disclosure pursuant to 17 CFR 229.402(w)(1)(ii) and (iii).

For example, an issuer may be acting reasonably promptly in establishing a deferred payment plan that allows the executive officer to repay owed erroneous compensation as soon as possible without unreasonable economic hardship to the executive officer, depending on the particular facts and circumstances.[304] The final rules also do not prohibit an issuer from establishing compensation practices that account for the possibility of the need for future recovery; while we acknowledge the many suggestions by commenters in this regard, we decline to offer specific guidance on which methods may be appropriate, as it will depend on the particular facts and circumstances applicable to that issuer. Finally, we note that the final rules do not restrict exchanges from adopting more prescriptive approaches to the timing and method of recovery under their rules in compliance with Section 19(b) of the Exchange Act, including after they have observed issuer performance and use any resulting data to assess the need for further guidelines to ensure prompt and effective recovery.

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.

1. Proposed Amendments

The Commission proposed to require that issuers disclose their recovery policies as an element of the listing standards, so that exchanges could commence de-listing proceedings for

[304] In response to the commenter who asked for clarification regarding whether a deferred repayment plan would be a prohibited personal loan under 15 U.S.C. 78m(k), as a general matter, we would not view such arrangements that are narrowly tailored to the compensation being recovered and in order to facilitate full payment as promptly as is reasonable under the circumstances as being a prohibited personal loan.

issuers that fail to make the required disclosure, as well as those that fail to adopt recovery policies or those that fail to comply with the terms of their policy.

In addition, the Commission proposed amendments to its rules and relevant forms to require disclosure about, and the filing of, the issuer's recovery policy. Specifically, the Commission proposed:

- Amending Item 601(b) of Regulation S-K to require that an issuer file its recovery policy as an exhibit to its annual report on Form 10-K;
- Adding Item 402(w) of Regulation S-K to require issuers to disclose certain information about how they have applied their recovery policies, including the date of and amount of erroneously awarded compensation attributable to the accounting restatement, any estimates that were used in determining the amount, the amount that remains to be collected, and the names of, and amounts owed by, executive officers where amounts due are owed or forgone;
- Amending the Summary Compensation Table requirements of Item 402 of Regulation S-K to disclose the effect of any recovered amount;
- Amending rules to require the new compensation recovery disclosure pursuant to proposed Item 402(w) of Regulation S-K be structured using machine-readable eXtensible Business Reporting Language ("XBRL");[305] and
- Amending forms applicable to FPIs and listed funds to require the same information called for by proposed Item 402(w) of Regulation S-K.

In the Reopening Release, the Commission requested comment on whether additional

[305] The proposed structuring would be limited to block text tagging of the disclosures, rather than any additional detail tags for specific data points included within the compensation recovery disclosures. *See* Proposing Release at Section II.D.1.

disclosures would benefit investors, such as disclosure of how issuers calculated the erroneously awarded compensation, including their analysis of the amount of the executive officer's compensation that is recoverable under the rule, and, for incentive-based compensation based on stock price or TSR, disclosure regarding the determination and methodology that an issuer used to estimate the effect of stock price or TSR on erroneously awarded compensation. The Reopening Release also sought comment on whether to add check boxes to the Form 10-K cover page that indicate separately (a) whether the previously issued financial statements in the filing include an error correction, and (b) whether any such corrections are restatements that triggered a compensation recovery analysis during the fiscal year. The Commission additionally requested comment on whether any specific data points that are included within the new compensation recovery disclosure should be detail tagged using Inline XBRL.

2. Comments

While commenters generally supported some level of disclosure about an issuer's recovery policy, comments were mixed regarding the specific disclosures that should be required. Some commenters generally supported the proposed disclosure requirements, with several commenters stating that required disclosure under the Federal securities laws would promote consistency.[306] One commenter specifically supported the use of a listing standard requirement to disclose the issuer's recovery policy,[307] and others supported the proposed structure of the disclosure requirements as they would facilitate exchanges' ability to commence delisting proceedings for issuers that fail to make the required disclosure.[308] A few commenters

[306] *See, e.g.,* comment letters from ABA 1; Better Markets 1; and CFA Institute 1.

[307] *See* comment letter from Compensia.

[308] *See* comment letters from ABA 1; and Better Markets 1.

recommended requiring the issuer's recovery policy be posted on the issuer's website rather than requiring it to be filed, as proposed.[309]

We received a range of comments on the specific proposed disclosure requirements.[310] Some commenters supported proposed Item 402(w),[311] noting its relevance to say-on-pay and director election voting decisions,[312] and the insight the disclosure would provide into board decision-making.[313] Some commenters further supported requiring the additional disclosure requirements on which we requested comment in the Reopening Release.[314] Another commenter suggested that the disclosure would elicit a sufficient amount of detailed information about how

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309 *See, e.g.,* comment letters from ABA 1 (recommending following the compensation committee charter disclosure model which relies on website disclosure and noting that many issuers disclose their existing recovery policies on the corporate website and investors are familiar with accessing corporate governance policies there); and NACD.

310 We received limited comment regarding the proposal to adjust Summary Compensation Table disclosure, with one commenter expressly supporting the proposal (*see* comment letter from ABA 1) and another recommending that amounts recovered for periods earlier than the three years presented should be reported in a footnote (*see* comment letter from Mercer). One commenter questioned whether reducing amounts reported in the Summary Compensation Table Stock Awards and Option Awards columns would be inconsistent with reporting other modifications under ASC Topic 718 and whether a delay in grant date determination for share-based awards under ASC Topic 718 could result from a recovery policy consistent with Rule 10-D-1. *See* comment letter from TCA. That commenter expressed concern that such a delay would have a substantial and material impact on the disclosure timing for those awards in the Summary Compensation Table and Grants of Plan-Based Awards Table. We note that, assuming the conditions for establishing a grant date under ASC Topic 718 are otherwise met, having such a recovery policy should not affect the issuer's determination.

311 *See, e.g.,* comment letters from As You Sow 1; Better Markets 1; CII 1; CalPERS 1; and OPERS 1.

312 *See, e.g.,* comment letters from CalPERS 1; and CII 1 (noting its usefulness to institutional investors).

313 *See* comment letter from OPERS 1.

314 *See, e.g.,* comment letters on the Reopening Release from Better Markets 2 (supporting disclosure of how issuers calculate the recoverable amount, especially with regards to compensation based on stock price or TSR); CFA Institute 2; CII 3 (noting that such disclosures could be particularly helpful in assessing the company's executive compensation policies and practices for purposes of shareholder voting); ICGN; Public Citizen 2; and Occupy. *See also* comment letter from the Second Reopening Release from AFR 2 (supporting disclosure of how issuers calculate the recoverable amount). *But see* comment letter on the Reopening Release from ABA 2 (generally supporting disclosure, but suggesting inclusion of stock price and TSR would lead to complex disclosures regarding determination and methodology).

a listed issuer has enforced its compensation recovery policy.[315] Some commenters recommended expanding certain disclosure requirements.[316] Another commenter recommended further clarification of the requirements.[317]

In contrast, some commenters recommended reducing or omitting certain of the proposed disclosure requirements.[318] A number of commenters expressed concern or objected to identifying specific executive officers from whom recovery has not yet been made or where recovery was not pursued,[319] others raised concerns that the disclosure could violate data privacy

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315 *See* comment letter from ABA 1 (supporting tracking any amount of incentive-based compensation subject to recovery through the duration of the recovery obligation until that amount either is recovered or the issuer concludes that recovery would be impracticable).

316 *See, e.g.,* comment letters from Better Markets 1; and Public Citizen 1. These commenters recommended requiring identification of each executive officer from whom recovery is sought or obtained, the respective amounts, how the amounts were determined, and the status of the recovery effort. *See also* comment letters on the Reopening Release from CFA Institute 2; and ICGN (supporting disclosure of the timing, and materiality determination); and comment letter from ABA 1 (recommending requiring the issuer to identify the incentive-based compensation arrangements that were subject to recovery, to provide context for the amount of excess incentive-based compensation resulting from the restatement).

317 *See* comment letter from ABA 1 (recommending guidance as to when a restatement is considered completed for purposes of triggering the disclosure requirement and clarification that disclosure would be required where the issuer's calculation results in no erroneously awarded compensation and where no such compensation is recovered because the board determines recovery would be impracticable).

318 *See, e.g.,* comment letters from BRT 1; CAP; Compensia; Exxon; Japanese Bankers; Mercer; NACD; Pay Governance; S&C 1; and UBS. A few commenters objected to the inclusion of the disclosure in Item 402. *See* comment letter from Pay Governance (suggesting more disclosure in the proxy statement would be administratively burdensome); and comment letters from NACD; and Public Citizen 1 (recommending disclosure on Form 8-K). *See also* comment letters on the Reopening Release from Davis Polk 3 (suggesting that disclosure of the methodology for calculating the recoverable amounts would be burdensome, lack comparability, and involve litigation risk); McGuireWoods; and SCG 2 (suggesting that the disclosure could be confusing and would add legal, audit, compensation consulting, and other expenses).

319 *See, e.g.,* comment letters from BRT 1 (recommending board discretion to omit individuals' names given the range of potential factors including, security or safety concerns, the likelihood of ongoing confidential legal negotiations, or the potential personal impact of disclosure); CAP (expressing reputational concerns); Mercer (recommending against the disclosure and suggesting that exchanges could require individualized information in an issuer's submission to the exchange if critical to their compliance analysis); S&C 1 (suggesting that the specific identity of an executive will in most cases not be material to the evaluation of the boards' determination not to pursue recovery); and UBS (suggesting that naming individuals from whom the issuer determines not to recover is irrelevant and provides no benefit to shareholders). *See also* comment letter on the Reopening Release from McGuireWoods (recommending that compensation recovery disclosure regarding non-named executive officers be generalized).

laws of foreign jurisdictions,[320] and two others suggested that this disclosure would invite second-guessing the board's decisions.[321] Several of these commenters offered various alternative approaches to the disclosure requirement.[322]

In response to the request for comment in the Reopening Release some commenters supported adding check boxes to the cover page of Form 10-K.[323] Other commenters believed the check boxes would not provide useful information to investors and were not consistent with the Commission's modernization and simplification efforts.[324]

We similarly received varied comments on our proposal to require the disclosure be tagged using XBRL. Some commenters expressed support for the proposed implementation of XBRL data tagging.[325] Other commenters opposed the data tagging requirement,[326] while some

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320 *See, e.g.,* comment letters from Exxon (expressing concern that identifying the status of specific individuals in certain European Union and other jurisdictions could violate local data privacy laws); Japanese Bankers (expressing concern that the proposed disclosure may violate local personal information protection acts and noting that under Japanese law the scope of separate disclosure for financial reporting purposes is limited to certain highly compensated executives); and UBS (suggesting data privacy laws or regulations in various foreign jurisdictions could affect a listed issuer's ability to disclose personal information).

321 *See* comment letters from ABA 1 (further noting the requirement could subject executives to embarrassing disclosure as to why they are unable to pay); and Compensia.

322 *See, e.g.,* comment letters from CAP (recommending identifying only named executive officers); BRT 1 (recommending providing board discretion over whether to identify executive officers); and Japanese Bankers (recommending disclosure on forgone recovery only for those executive officers responsible for preparing and disclosing financial statements). *See also* comment letters from ABA 1; and Mercer (recommending aggregate disclosure of amounts forgone and outstanding together with the number of executives from whom recovery was not pursued and amounts outstanding).

323 *See, e.g.,* comment letters on the Reopening Release from CFA Institute 2; CII 3; ICGN (also supporting Form 8-K disclosure); and Occupy. *See also* comment letter on the Second Reopening Release from AFR 2.

324 *See, e.g.,* comment letters on the Reopening Release from Davis Polk 3; McGuireWoods (stating that information regarding restatements and recovery of compensation are sufficiently covered by other disclosure rules such that this check box would provide little additional informational value to investors); and SCG 2.

325 *See, e.g.,* comment letters from CII 1; CalPERS 1; and OPERS 1 (contending that tagging would lower investors' costs to collect the data and permit the information to be analyzed more efficiently).

326 *See, e.g.,* comment letters from CCMC 1; Davis Polk 1; FSR; FedEx 1; Hay Group; Mercer (recommending a comprehensive approach to tagging the proxy statement); and Pearl Meyer. Many of these commenters expressed concern regarding the cost of implementation versus the perceived benefits, such as the utility of the information to investors. *See, e.g.,* comment letters from CCMC 1; Davis Polk 1 (expressing concern about the comparability of the data); FSR; FedEx 1; and Pearl Meyer.

recommended making tagging optional,[327] or exempting SRCs and EGCs in view of the burden.[328] In response to the request for comment in the Reopening Release regarding compensation recovery disclosure being separately detail tagged using Inline XBRL, some commenters supported Inline XBRL requirements for the compensation recovery information, suggesting that such requirements would lead to more timely and less costly analysis of the new disclosures.[329] In contrast, some other commenters expressed concern or opposed the Inline XBRL requirements discussed in the Reopening Release, citing compliance costs and lack of comparability across filers as specific concerns.[330]

3. Final Amendments

After considering the views of commenters, we are adopting substantially as proposed rules to require that listed issuers disclose their recovery policies as an element of the listing standards and to require disclosure about, and the filing of, the issuer's recovery policy, in Commission filings. After considering comments to the Reopening Release, and in a change from the proposal, the final rules will additionally require: disclosure relating to an issuer's compensation recovery policy and recovery; tagging of the additional information in Inline XBRL; and additional check box disclosure on the cover of the Forms 10-K, 20-F, and 40-F.

We believe Sections 10D(a) and (b) are intended to require listed issuers to adopt, comply with, and provide disclosure about their compensation recovery policies. Accordingly,

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327 *See* comment letter from Hay Group.

328 *See* comment letters from ABA 1; and Hay Group.

329 *See, e.g.*, comment letters on the Reopening Release from CFA Institute 2; CII 3; and XBRL US (Aug. 30, 2021) (recommending that the disclosure be tagged using Inline XBRL and be incorporated into the definitive proxy or information statement).

330 *See, e.g.*, comment letters on the Reopening Release from ABA 2; Davis Polk 3; and McGuireWoods. These commenters suggested that varying recovery processes may necessitate custom tagging, which would undermine comparability issues and thus limit the benefits of tagging.

Rule 10D-1 requires the listing standards adopted by exchanges to include that listed issuers disclose their recovery policies.[331] As noted above, as a result of implementing the disclosure requirement as an element of the listing standards, we would expect exchanges to commence delisting proceedings for issuers that fail to make the required disclosure. 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 permits 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 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. To provide consistent disclosure across exchanges, Rule 10D-1 provides that the required disclosure about the issuer's recovery policy must be filed in accordance with the disclosure requirements of the Federal securities laws. [332] Amended Item 601(b) of Regulation S-K requires that an issuer file its recovery policy as an exhibit to its annual report on Form 10-K.[333] Structuring the provision in this manner provides that, in addition to making the

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331 *See* 17 CFR 240.10D-1(b)(2).

332 *Id*.

333 17 CFR 229.601(b)(97). In a modification from the proposal, we are designating the exhibit containing the compensation recovery policy as Item 601(b)(97) rather than Item 601(b)(96) as was proposed because Item 601(b)(96) is currently in use. In addition, we are moving the definition of the affected registrant to the operative text rather than defining "listed registrant" for purposes of Item 601(b)(97). Corresponding filing requirements will apply to listed FPIs and registered management investment companies subject to Rule 10D-1. We are correspondingly amending the Form 20-F Instructions as to Exhibits to add new Instruction 97 and Form 40-F to add new paragraph 19(a) to General Instruction B. Form N-CSR is also being amended to renumber Item 18 (Exhibits) as Item 19 and add new paragraph (a)(2) to that item (and redesignating current paragraph (a)(2) as paragraph (a)(3)) for those registered management investment companies that are subject to the requirements of Rule 10D-1.

disclosure a condition to listing, it is also subject to Commission oversight to the same extent as other disclosure required in Commission filings.

In connection with our implementation of Section 10D(b)(1), we are also using our discretionary authority to amend Item 402 of Regulation S-K, Form 40-F, and Form 20-F to require listed issuers to disclose how they have applied their recovery policies.[334] In addition to new Item 402(w), we are adding substantially as proposed a new instruction to the Summary Compensation Table to require that any amounts recovered pursuant to a listed issuer's compensation recovery policy reduce the amount reported in the applicable column, as well as the "total" column" for the fiscal year in which the amount recovered initially was reported and be identified by footnote.[335]

As adopted,[336] 17 CFR 229.402(w)(1) ("Item 402(w)(1)")[337] applies if at any time during or after its last completed fiscal year the issuer was required to prepare an accounting restatement that required recovery of erroneously awarded compensation pursuant to the listed issuer's compensation recovery policy required by the listing standards adopted pursuant to Rule 10D-1, or there was an outstanding balance as of the end of the last completed fiscal year of erroneously awarded compensation to be recovered from the application of that policy to a prior restatement.[338]

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334 *See* new Item 402(w) of Regulation S-K, Item 6.F. of Form 20-F, and Instruction 19 of Form 40-F.

335 *See* Instruction 5 to 17 CFR 229.402(c), and Instruction 5 to 17 CFR 229.402(n). The language from the proposal has been revised for clarity but the revisions do not affect the substance of the instructions.

336 In a nonsubstantive modification from the proposed rules and in order to streamline the rule, we have removed the separate definitions of certain terms and incorporated the substance of the definition into the text of the rule.

337 All domestic listed issuers are subject to Item 402(w) disclosure and are required to provide the disclosure along with the issuer's other Item 402 disclosure as part of an issuer's annual reporting obligation. *See* Item 11. Executive Compensation of Form 10-K.

338 *See* Item 402(w)(1). The revised language of Item 402(w)(1) more clearly delineates when the disclosure is required and also addresses the commenter who asked for clarification of when a restatement is considered "completed." This is because the trigger for disclosure is now when the issuer determines that it is required to

In these circumstances, an issuer will be required to provide the following information in its Item 402 disclosure:

- The date on which the listed issuer was required to prepare an accounting restatement and the aggregate dollar amount of erroneously awarded compensation attributable to such accounting restatement (including an analysis of how the recoverable amount was calculated)[339] or, if the amount has not yet been determined, an explanation of the reasons and disclosure of the amount and related disclosures in the next filing that is subject to Item 402 of Regulation S-K;[340]
- The aggregate dollar amount of erroneously awarded compensation that remains outstanding at the end of its last completed fiscal year;[341]
- If the financial reporting measure related to a stock price or TSR metric, the estimates used to determine the amount of erroneously awarded compensation attributable to such

prepare the restatement, which is the same event that triggers the issuer to comply with its compensation recovery policy pursuant to Rule 10D-1.

339 In a modification from the proposal, 17 CFR 229.402(w)(1)(i)(B) will require an analysis of how the amount of erroneously awarded compensation was calculated. We believe that investors will benefit from disclosure of the analysis of how the amount was calculated and agree with commenters that suggested such disclosures could be particularly helpful in assessing the issuer's executive compensation policies and practices for purposes of shareholder voting.

340 *See* 17 CFR 229.402(w)(1)(i)(A), (B), and (E). In another modification from the proposal, proposed Instruction 4 to Item 402(w) has been incorporated into the rule as 17 CFR 229.402(w)(1)(i)(E) ("Item 402(w)(1)(i)(E)") and provides as proposed that if the aggregate dollar amount of erroneously awarded compensation has not yet been determined, the listed issuer must disclose this fact and explain the reasons. Item 402(w)(1)(i)(E) also now includes a requirement, when the amount has not yet been determined, to disclose the amount and related disclosures in the next filing that is subject to Item 402 of Regulation S-K. This modification was necessary, because otherwise the issuer would not be required to disclose the determined amount in a subsequent year unless the amount is still outstanding at the end of the year.

341 *See* 17 CFR 229.402(w)(1)(i)(D). To the extent that a company determines recovery is impracticable in reliance on the exceptions in 17 CFR 240.10D-1(b)(1)(iv), the balance would no longer be outstanding and disclosure under this section would no longer be provided.

accounting restatement and an explanation of the methodology used for such estimates;[342]

- If recovery would be impracticable pursuant to 17 CFR 240.10D-1(b)(1)(iv) ("Rule 10D-1(b)(1)(iv)"), for each current and former named executive officer and for all other current and former executive officers as a group, disclose the amount of recovery forgone and a brief description of the reason the listed registrant decided in each case not to pursue recovery;[343] and
- For each current and former named executive officer, disclose the amount of erroneously awarded compensation still owed that had been outstanding for 180 days or longer since the date the issuer determined the amount owed.[344]

We continue to believe that disclosure regarding the use of the impracticability exception in Rule 10D-1(b)(1)(iv) will provide information to shareholders and exchanges that will help them monitor the implementation of an issuer's recovery policy. Any brief description of the reason an issuer determined not to pursue recovery should include the element of Rule 10D-1(b)(1)(iv) that caused the impracticability, and should provide additional context relating to that element, such as:

- A brief explanation of the types of direct expenses paid to a third party to assist in enforcing the recovery policy, if the issuer is relying on Rule 10D-1(b)(1)(iv)(A);

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342 *See* 17 CFR 229.402(w)(1)(i)(C).

343 *See* 17 CFR 229.402(w)(1)(ii).

344 In response to commenters' concerns regarding the privacy of executive officers, in a modification from the Proposing Release the final amendments limit these detailed disclosures to current and former named executive officers. We are requiring the more detailed disclosure for current and former named executive officers for the same reasons as those discussed at note 343 *supra*. *See* 17 CFR 229.402(w)(1)(iii). More general information about amounts remaining outstanding is required by 17 CFR 229.402(w)(1)(i)(D).

- Identification of the provision of foreign law the recovery policy would violate if the issuer is relying on Rule 10D-1(b)(1)(iv)(B); or
- A brief explanation of how the recovery policy would cause an otherwise tax-qualified retirement plan to fail to meet the requirements of 26 U.S.C. 401(a)(13) or 26 U.S.C. 411(a), if the issuer is relying on Rule 10D-1(b)(1)(iv)(C).

Upon further consideration and in response to commenters concerns regarding the privacy of executive officers,[345] in a modification from the Proposing Release the final amendments require specific disclosure regarding use of the impracticability exception with respect only to the current and former named executive officers. The final amendments require more generalized disclosure regarding use of the impracticability exception with respect to other current and former executive officers as a group. Aggregated disclosure of recovery from the group of officers other than named executive officers is consistent with the registrant's reporting obligations for executive compensation purposes, and will help investors to monitor the registrant's implementation of its recovery obligation. However, we believe that more detailed information for the named executive officers is appropriate, as it will be relevant to investors' understanding of current and prior compensation disclosures.

We are also adopting the amendment to Item 404(a) providing that an issuer that complies with its Item 402(w) disclosure requirements need not disclose any incentive-based compensation recovery pursuant to Item 404(a).[346]

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[345] *See* notes 319 through 322.

[346] Item 404(a) requires a description of certain transaction between the issuer and a related person. To avoid duplicative disclosure, we are amending Instruction 5.a.iii to Item 404(a) of Regulation S-K largely as proposed. We are clarifying the description of affected compensation in the instruction to indicate that it applies to erroneously awarded compensation computed as provided in 17 CFR 240.10D-1(b)(1)(iii) and the applicable listing standards for the registrant's securities. *See also* Instruction 1 to Item 22(b)(20) of Schedule 14A for registered management investment companies (information provided pursuant to Item 22(b)(20) is

The requirements elicit disclosure regarding an issuer's activity to recover erroneously awarded compensation during its last completed fiscal year. In a nonsubstantive modification from the proposal, we are adopting the substance of Instruction 5 to Item 402(w) as new 17 CFR 229.402(w)(3), which limits the disclosure requirement to proxy or information statements that call for Item 402 disclosure and the issuer's annual report on Form 10-K and provides that the information required by 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. As this information is similar to other executive compensation information required by Item 402 and is likely to serve a similar purpose for investors in evaluating the issuer and making voting decisions, we believe that the information is most relevant to shareholders in an issuer's proxy or information statements that call for Item 402 disclosure and the issuer's annual report on Form 10-K.

As proposed, the disclosure will be required as a separate item rather than as an amendment to the CD&A requirement because the requirements apply to any current or former

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)). *See also* Item 7.B to Form 20-F for FPIs (disclosure need not be provided pursuant to this Item if the transaction involves the recovery of erroneously awarded compensation that is disclosed pursuant to Item 6.F).

executive officer, not just "named executive officers" and CD&A requirements do not apply to SRCs, EGCs, and FPIs,[347] all of which are subject to the new requirements.[348]

With respect to registered management investment companies subject to Rule 10D-1, the final rules will require information mirroring the Item 402(w) disclosure to be included in annual reports on Form N-CSR and in proxy statements and information statements relating to the election of directors.[349] Similarly for listed FPIs, the same information called for by Item 402(w) will be required in their annual reports filed with the Commission pursuant to Section 13(a) or Section 15(d) of the Exchange Act, such as on Form 20-F or, if the issuer elects to use the registration and reporting forms that U.S. issuers use, on Form 10-K.[350] MJDS filers will be required to provide this information in annual reports on Form 40-F.[351]

In addition, we are amending the cover page of Form 10-K, Form 20-F, and Form 40-F to add check boxes that indicate separately (a) whether the financial statements of the registrant

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[347] SRCs and EGCs are not required to provide CD&A in accordance with the scaled disclosure requirements contained in Item 402 of Regulation S-K. *See* 17 CFR 229.402(*l*) and Section 102(c) of the JOBS Act. FPIs 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, FPIs 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* 17 CFR 229.402(a)(1) of Regulation S-K.

[348] We note that a listed issuer required to provide CD&A could choose to include the Item 402(w) disclosure in its CD&A discussion of its recovery policies and decisions pursuant to 17 CFR 229.402(b)(2)(viii) of Regulation S-K, which could benefit investors by disclosing all compensation recovery information together in the filing.

[349] *See* Item 18 of Form N-CSR; Item 22(b)(20) of Schedule 14A. We are also amending General Instruction D to Form N-CSR to permit registered management investment companies subject to Rule 10D-1 to answer the information required by Item 18 by incorporating by reference from the company's definitive proxy statement or definitive information statement. In addition, we are amending 17 CFR 270.30a-2 to reflect the new item numbers in Form N-CSR. We are also cross-referencing Item 18 of Form N-CSR in Item 22(b)(20) of Schedule 14A rather than restating the requirements of Form N-CSR in Schedule 14A.

[350] Because securities registered by these listed issuers are exempt from Section 14(a) of the Exchange Act, these issuers are not required to disclose any proxy or consent solicitation materials with respect to their securities under that provision. *See* Item 6.F of Form 20-F.

[351] *See* Paragraph (19) of General Instruction B of Form 40-F.

included in the filing reflect correction of an error to previously issued financial statements, and (b) whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period pursuant to §240.10D-1(b).[352] Comments in response to the Reopening Release generally supported the addition of check boxes to the cover page of Form 10-K.[353] Particularly as it relates to "little r" restatements which typically are not disclosed or reported as prominently as "Big R" restatements, the check boxes provide greater transparency around such restatements and easier identification for investors of those that triggered a compensation recovery analysis. Although the Reopening Release did not specifically ask about Forms 20-F and 40-F, these forms serve corresponding purposes as Form 10-K, and for similar reasons, we believe it will be beneficial to investors to include similar check boxes on the cover pages of these forms and note that their inclusion will be a relatively low burden. We are not adopting the check-box requirement for annual reports filed on Form N-CSR because the current content and formatting requirements for registered management investment companies' annual reports do not otherwise include check boxes, and because we anticipate that a limited number of registered management investment companies will be affected by the final rules.[354]

Relatedly, in a modification from the proposal, to allow investors to understand the check boxes in the appropriate context of the issuer's application of its recovery policy, we are adding a

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[352] In a nonsubstantive change from the Reopening Release, we have refined certain terminology for clarity.

[353] While we recognize some commenters' concerns regarding the usefulness of the information provided by the check boxes and their views that additional check boxes do not simplify the disclosure, we believe that the check boxes will help investors more readily identify restatements by issuers and whether any of the restatements triggered a compensation recovery analysis. *See supra* note 324. We agree with those commenters that suggested that compensation recovery analysis is relevant to investors such that a check box appropriately highlights the issue. *See supra* note 323.

[354] We estimate that only seven registered management investment companies that are listed issuers and are internally managed may have executive officers who receive incentive-based compensation, and thus could be subject to the new rules.

disclosure requirement in a new 17 CFR 229.402(w)(2) to require that, if at any time during its last completed fiscal year a registrant prepared an accounting restatement, and the registrant concluded that recovery of erroneously awarded compensation was not required pursuant to the registrant's compensation recovery policy required by the listing standards adopted pursuant to Rule 10D-1, the issuer must briefly explain why application of its recovery policy resulted in this conclusion. The additional disclosure will provide useful context to investors and the exchanges when an issuer has issued an accounting restatement and facilitates a better understanding of how an issuer is applying its recovery policy.

Finally, in a modification from the proposal, we are requiring tagging of any specific data points included within the compensation recovery disclosures, as well as block text tagging of those disclosures, in Inline XBRL.[355] Because existing Commission rules require the Inline XBRL tagging of all cover page information on Forms 10-K, 20-F, and 40-F, the two new cover page check boxes will be tagged in Inline XBRL.[356] We recognize some commenters' concerns relating to the costs of implementing the use of XBRL and their additional concerns that the data may lack comparability across filers, including as a result of custom tagging, which may limit its utility to investors. However, we agree with other commenters that Inline XBRL requirements will facilitate analysis of the new compensation recovery disclosures, even in situations where the particular characteristics of compensation recovery programs, such as the methods by which filers calculate the amount of erroneously awarded compensation, may not be fully comparable across filers (*e.g.*, by enabling analysis of trends in a single filer's disclosures over multiple

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[355] *See* 17 CFR 229.402(w)(4) of Regulation S-K and 17 CFR 232.405 (Rule 405 of Regulation S-T). In a nonsubstantive modification from the proposal, we have moved the appearance and formatting requirement to 17 CFR 229.402(w)(3) and have separately addressed requirements relating to interactive data in 17 CFR 229.402(w)(4).

[356] *See* 17 CFR 229.601(b)(104) and 17 CFR 232.406 (Rule 406 of Regulation S-T). Issuers will thus be required to use the most updated versions of all taxonomies used to tag the filing to comply with the rule.

reporting periods). Requiring Inline XBRL tagging of the compensation recovery disclosure benefits investors by making the disclosures more readily available and easily accessible to investors, market participants, and others for aggregation, comparison, filtering, and other analysis, as compared to requiring a non-machine-readable data language such as ASCII or HTML. At the same time, we do not expect the incremental compliance burden associated with tagging the additional information to be unduly burdensome, because issuers subject to the tagging requirements are, or in the near future will be, subject to similar Inline XBRL requirements in other Commission filings.[357]

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. In the context of Securities Act registration statements, a registrant is required to state the general effect of any statute, charter provisions, bylaws, contract or other arrangements under which any controlling person, director, or officer of the registrant is insured or indemnified in any manner against liability which he may incur in his capacity as such.[358]

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[357] As noted in the Reopening Release, subsequent to the proposal, the Commission adopted rules replacing XBRL tagging requirements for issuer financial statements and open-end fund risk/return summary disclosures with Inline XBRL tagging requirements. Inline XBRL embeds the machine-readable tags in the human-readable document itself, rather than in a separate exhibit. *See Inline XBRL Filing of Tagged Data*, Release No. 33-10514 (June 28, 2018) [83 FR 40846 (Aug. 16, 2018)]. As a result of those changes, we are using Inline XBRL, rather than XBRL, for the tagging requirements. *See also Securities Offering Reform for Closed-End Investment Companies*, Release No. 33-10771 (Apr. 8, 2020) [85 FR 33290 (June 1, 2020) at 33318]. Inline XBRL requirements for business development companies will take effect beginning Aug. 1, 2022 (for seasoned issuers) and Feb. 1, 2023 (for all other issuers).

[358] *See* 17 CFR229.702.

1. Proposed Amendments

The Commission proposed that listed issuers would be prohibited from indemnifying any executive officer or former executive officer against the loss of erroneously awarded compensation. 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 officer for premiums for such an insurance policy.

2. Comments

We received mixed comments on the proposal that listed issuers be prohibited from indemnifying any executive officer or former executive officer against the loss of erroneously awarded compensation. A number of commenters expressly supported the proposed treatment of indemnification and insurance.[359] Some of these commenters suggested that permitting indemnification would fundamentally undermine the purpose of the statute and effectively nullify the mandatory nature of the compensation recovery.[360] Some commenters recommended that the Commission go even further, such as by discouraging or prohibiting executive officers from procuring their own insurance.[361]

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[359] *See, e.g.,* comment letters from; AFL-CIO; AFR 1; CalPERS 1; and Rutkowski 1. *See also* comment letter from ABA 1 (expressing qualified support, but stating that issuers should not be prohibited from indemnifying executives' litigation expenses in compensation recovery actions consistent with state law, noting that these arrangements permit advancement of legal expenses incurred in defending a claim by the issuer if the executive "acted 'in good faith' and in a manner reasonably believed to be, or not opposed to, the best interests of the issuer").

[360] *See, e.g.,* comment letters from AFL-CIO; AFR 1; and Rutkowski 1.

[361] *See, e.g.,* comment letters from American Insurance Association ("AIA"); Better Markets 1; FSR; and TCA.

In contrast, a number of commenters expressed concerns with the proposed prohibition.[362] Some of these commenters contended that Section 10D does not prohibit indemnification.[363] One commenter recommended the approach in 17 CFR 229. 512(h) where the Commission expresses its opinion regarding indemnification, but does not prohibit it by rule.[364] Some others asserted that a prohibition on indemnification or issuer-paid insurance would be appropriate only where recovery is premised on fraud or misconduct.[365] Commenters additionally expressed concern that the rule could be construed to conflict with state law provisions providing for indemnification under certain circumstances.[366]

3. Final Amendments

After considering the views of commenters, we are adopting as proposed rules to prohibit issuers from insuring or indemnifying any executive officer or former executive officer against the loss of erroneously awarded compensation.[367] While an executive officer may be able to

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362 *See, e.g.,* comment letters from Bishop (expressing concern over retroactive application to existing compensation agreements); CCMC 1; Compensia (suggesting compensation payments in the ordinary course of business could be mistaken for indemnification and recommending guidance); NACD; Pearl Meyer (expressing concern that a prohibition on indemnification could adversely affect a public company's ability to hire executive officers); and SCG 1.

363 *See, e.g.,* comment letters from Bishop (suggesting that "will" in Section 10D expresses "a simple futurity" whereas "shall" expresses an obligation); CCMC 1 (suggesting the proposal may exceed the Commission's authority as it would touch on state regulation of insurance products); and SCG 1.

364 *See* comment letter from CCMC 1. 17 CFR 229.512(h) provides that if acceleration of a Securities Act registration statement is requested, the registration statement is required to include an undertaking stating that the registrant has been advised that in the opinion of the Securities and Exchange Commission indemnification of directors, officers and controlling persons for liabilities arising under the Securities Act is against public policy as expressed in the Securities Act and is therefore unenforceable. The undertaking further provides that in the event that such a claim for indemnification is asserted, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

365 *See* comment letters from NACD; and SCG 1.

366 *See* comment letters from Bishop; and SCG 1 (suggesting that the risk of private litigation would justify issuer indemnification and insurance and citing to the General Corporation Law of Delaware that provides for indemnification where the agent has been successful on the merits).

367 *See* 17 CFR 240.10D-1(b)(1)(v).

purchase a third-party insurance policy to fund potential recovery obligations, the indemnification provision prohibits an issuer from paying or reimbursing the executive officer for premiums for such an insurance policy.[368]

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."[369] The Proposing Release acknowledged that 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.[370] However, 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.[371] Indemnification arrangements that permit

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368 Such indemnification or reimbursement would also be prohibited through modification to current compensation arrangements or other means that would amount to *de facto* indemnification, such as, for example, by providing an executive a new cash award which the issuer would then "cancel" to effect recovery of outstanding recoverable amounts.

369 *See* Senate Report at 136.

370 *See* Proposing Release at Section II.F.

371 *See Cohen v. Viray*, 622 F.3d 188, 195 (2d Cir. 2010) (holding that an indemnification agreement cannot be used to release the CEO and CFO from liability to repay compensation under Sarbanes-Oxley Act Section 304, 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 officer's purchase of this coverage, the executive officer retains the excess compensation to which he or she was not entitled.

executive officers to retain or recover compensation that they were not entitled to receive based on restated financial statements would fundamentally undermine the purpose of Section 10D.[372]

We further believe that Section 29(a) of the Exchange Act would render any indemnification agreement void and unenforceable to the extent that the agreement purported to relieve the issuer of its obligation under Section 10(D), Rule 10D-1, and a resulting listing standard to recover erroneously paid incentive-based compensation. Section 29(a) provides that any 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.[373] 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.'"[374]

We acknowledge commenters who raised various concerns with respect to the prohibition on issuers insuring or indemnifying executive officers with respect to recoverable compensation. While we acknowledge that states may have specific provisions permitting issuers to indemnify or insure their executive officers in certain circumstances, we are unaware of any provisions that mandate such indemnification or insurance, and as such, we do not believe the final rules are in

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372 *See 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").

373 15 U.S.C. 77cc. National securities exchanges and national securities associations are self-regulatory organizations. 15 U.S.C. 78c(a)(26).

374 *See 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)). *See also Cohen v. Viray*, 622 F.3d at 195 (citing Section 29(a) in rejecting indemnification against Sarbanes-Oxley Act Section 304 liability); and *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).

conflict with such provisions. We also acknowledge, as one commenter observed, that states regulate certain insurance products. Nevertheless, we believe Rule 10D-1's prohibition is necessary to ensure that the recovery policy mandated by Congress for issuers listed on U.S. national exchanges is given actual effect. Additionally, because the rules apply to all listed issuers, with limited exceptions, we do not find the assertions by commenters that such prohibitions would put issuers at a disadvantage in the ability to hire executive officers to be compelling. In light of Section 10D's mandate to return to issuers and shareholders compensation that was erroneously awarded, we agree with commenters who asserted that any issuer indemnification or insurance of an executive officer's obligation to return erroneously awarded compensation would be contrary to the statute, and therefore, we continue to believe it is appropriate to restrict an issuer's ability to do so.

F. Transition and Timing

Section 10D does not address transition and timing of implementation of the rules.

1. Proposed Amendments

The Commission proposed that each exchange be required to file its proposed listing standards no later than 90 days following publication of the final rules in the Federal Register, and that such listing standards be effective no later than one year following that same publication date. Further, each listed issuer would be required to adopt a compliant recovery policy no later than 60 days following the date on which the listing rules to which it is subject become effective. The Commission also proposed that each listed issuer be required to recover pursuant to the issuer's recovery policy 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.

Finally, the Commission proposed that an issuer be required to file the required disclosures in the applicable Commission filings required on or after the date on which the listing standards become effective.

2. Comments

We received limited comment on transition and timing. One commenter found the proposed schedule for the exchanges to file their proposed listing standards and have them declared effective to be "workable and appropriate."[375]

Commenters that addressed the issue generally supported applying recovery policies only to incentive-based awards granted or performance periods that begin after the effective date of the relevant exchange listing standards[376] or the effective date of the final rules.[377] Some of these commenters expressed concerns regarding retroactive application of the rules,[378] with one noting that applying the rule to awards earned or vested after the effective date of Rule 10D-1 could pick up awards granted prior to the effective date.[379] A number of commenters also expressed concern regarding the effect of the rules on existing contracts, noting that existing contracts typically can be amended only with consent.[380] Finally, some commenters thought the

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375 *See* comment letter from ABA 1.

376 *See, e.g.,* comment letters from ABA 1; BRT 1; Compensia; Chevron; Mercer; and NACD.

377 *See, e.g.,* comment letters from CCMC 1; Coalition; Meridian; and SCG 1.

378 *See* comment letters from CCMC; and Coalition.

379 *See* comment letter from Chevron.

380 *See, e.g.,* comment letters from ABA 1 (stating that if the rule is not applied on a wholly prospective basis, it should apply only to erroneously awarded compensation granted after the effective date of final Rule 10D-1); BRT 1; CCMC 1; Coalition; Mercer; Meridian; NACD (stating that questions of contractual violations are serious and may not be resolved merely through an amendment to by-laws); and SCG 1 (suggesting that issuers may only be able to amend plans on a prospective basis, as plans often prohibit amendments that impair a

proposed 60-day period for issuers to adopt their recovery policies following the effective date of the exchanges' listing rules was too short and recommended additional time.[381]

3. Final Amendments

After considering the views of commenters, we are adopting transition and timing requirements substantially as proposed, with a modification in response to commenters (as described below). Under the final amendments, issuer compliance is 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.

Under the rules we are adopting: (i) each exchange will be required to file its proposed listing standards no later than 90 days following the [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER], (ii) the listing standards must be effective no later than one year following the [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER], and (iii) each issuer subject to such listing standards will be required to adopt a recovery policy no later than 60 days following the date on which the applicable listing standards become effective.[382] We would not expect compliance with the disclosure requirement until issuers are required to have a policy under the applicable exchange listing standard.

As noted above, several commenters raised concerns about application of the mandated recovery policy to compensation that was granted prior to the effective date of the rules. In a

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participant's rights to an outstanding award, unless the participant consents). *See also* comment letters in response to the Reopening Release from ABA 2; Cravath; Hunton; McGuireWoods; and SCG 2. Some of these commenters recommended exceptions for existing contracts or awards (Cravath and Hunton) or an exception for compensation paid pursuant to existing employment and equity award agreements (SCG 2).

381 *See* comment letters from ABA 1 (recommending an exemption or a delayed phase-in of at least two years for SRCs and EGCs); NACD (recommending 90 days); and Davis Polk 1 (recommending six months).

382 *See* 17 CFR 240.10D-1(a)(2) and (3).

modification from the proposal in response to these concerns, and to provide an additional transition period, the final rules provide that each listed issuer is required to comply with the recovery policy for all incentive-based compensation received (as defined in 17 CFR 240.10D-1(d)[383]) by current or former executive officers on or after the effective date of the applicable listing standard (as opposed to the effective date of Rule 10D-1).[384] In addition, each listed issuer is required to provide the disclosures required by the rule and Item 402(w) in the applicable Commission filings required on or after the date on which the exchanges' listing standards become effective.[385]

Notwithstanding these extended transition periods, we recognize that there could be incentive-based compensation that is the subject of a compensation contract or arrangement that existed prior to the effective date of Rule 10D-1 which was not received until after the effective date of the applicable listing standards—and therefore would be subject to recovery under the final amendments. We do not believe this would be an inappropriate application of the mandated recovery policy. In our view, executives do not have a reasonable settled expectation in retaining compensation that was erroneously awarded based on misreported financial metrics, particularly when those financial metrics were attained on or after the effective date of the applicable listing standards, as contemplated by the final amendments. For similar reasons, we do not believe it is inappropriate to apply the mandated recovery policy to pre-existing

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383 Rule 10D-1 states "[i]ncentive-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."

384 *See* 17 CFR 240.10D-1(a)(3)(ii). Notwithstanding the look-back requirement in 17 CFR 240.10D-1(b)(1)(i)(D), an issuer is only required to apply the recovery policy to incentive-based compensation received after the effective date of the applicable listing standard.

385 *See* 17 CFR 240.10D-1(a)(3)(iii). Issuers subject to such listing standards will be required to adopt a recovery policy no later than 60 days following the date on which the applicable listing standards become effective and must begin to comply with these disclosure requirements in proxy and information statements and the issuer's annual report on Form 10-K on or after the issuer adopts its recovery policy.

compensation contracts or arrangements.

While we acknowledge commenter concerns about the need for adequate time to prepare for the application of the listing standards and the development of appropriate recovery policies, including in some cases the renegotiation of certain contracts, we believe the final rules provide ample time for such preparations. In that regard, we note that issuers will have more than a year from the date the final rules are published in the Federal Register to prepare and adopt compliant recovery policies. We believe the prescriptive nature of Rule 10D-1 provides issuers with sufficient notice to begin such preparations concurrently with listing standards being finalized.

III. OTHER MATTERS

If any of the provisions of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

Pursuant to the Congressional Review Act, the Office of Information and Regulatory Affairs has designated these rules a "major rule," as defined by 5 U.S.C. 804(2).

IV. 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 exchanges and associations to prohibit the listing of issuers that do not develop and implement policies to recover erroneously awarded incentive-based compensation.[386] The policies must provide that, in the event that the issuer is required to prepare an accounting restatement due to the issuer's material

[386] *See* Section I.

noncompliance with any financial reporting requirement under the securities laws,[387] 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. From an economic perspective, when implemented, this change will effectively return the erroneously awarded compensation to the shareholders. 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 adopting a new rule and rule amendments to satisfy the statutory mandates of Section 10D. As discussed above, we believe the intent of these statutory mandates is to require the return of executive compensation that was awarded erroneously to the issuer and its shareholders.

We have reviewed the letters and information provided by commenters, and performed an analysis of the main economic effects that may flow from the rules being adopted in this release. We consider the economic impact — including the costs and benefits and the impact on efficiency, competition, and capital formation — of the final rule requirements on issuers and other affected parties, relative to the baseline discussed below. 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

[387] The trigger events would include both "Big R" and "little r" restatements that correct errors in previously issued financial statements. *See* Section II.B.

efficiency, competition, and capital formation.[388] Further, Section 23(a)(2) of the Exchange Act requires us, when making rules under the Exchange Act, to consider the impact any new rule would have on competition and 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.[389] Where practicable, we have attempted to quantify the effects of the final rules; however, in many cases, we are unable to do so because we lack the data necessary to provide a reasonable estimate. For purposes of this economic analysis, we address the costs and benefits resulting from the statutory mandate and from our exercise of discretion together, recognizing that it is difficult to separate the costs and benefits arising from these two sources.

A. Baseline

To assess the economic impact of the final rules, 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. We begin by analyzing affected issuers, including the prevalence of incentive-based compensation. Next, we provide information on the frequency of restatements as triggering events. We also provide information on the regulatory baseline. Finally, we provide information on how many issuers currently have compensation recovery provisions, as well as descriptive information regarding those provisions.

[388] *See* 15 U.S.C. 78c(f); 15 U.S.C. 80a-2(c).

[389] *See* 15 U.S.C. 78w(a)(2).

We recognize that a substantial number of issuers[390] will be affected, since incentive-based compensation[391] is widely used. Although statistics reflecting the prevalence of incentive-based compensation precisely as defined in this rulemaking are not available, one study[392] found that 97% of a representative sample of the S&P 500 companies grant performance-based compensation as part of their long-term incentive plans, though the prevalence might be lower among smaller companies.[393]

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390 As a starting point to describe the number of affected issuers, we identify the number of exchange listed companies. As of Dec. 31, 2021, there were approximately 5,300 exchange listed companies (excluding closed end funds and REITs). We recognize that there are many companies that, because they are not exchange listed, will not be affected by these rules. For instance, on Aug. 22, 2022, there were 12,454 securities quoted on OTCmarket.com, (*see* OTC Markets Grp. Inc., *Current Market*, OTC MARKETS (Aug. 22, 2022), https://www.otcmarkets.com/market-activity/current-market) and from 2013-2015 there were roughly 10,000 stocks quoted on OTC markets. *See* Josh White, *Outcomes of Investing in OTC Stocks*, (working paper, Dec. 16, 2016), *available at* https://www.sec.gov/files/White_OutcomesOTCinvesting.pdf.

391 Compensation that may trigger recovery under the final rules includes amounts awarded under long-term incentive plans (such as performance-based equity) or short-term incentive plans (such as cash bonuses) that are granted, vested, or whose size is determined based on a financial metric.

392 *See* Meridian Compensation Partners, *2021 Corporate Governance and Incentive Design Survey* (Fall 2021), *available at* https://www.meridiancp.com/insights/2021-corporate-governance-and-incentive-design-survey/ ("Meridian Report") (97% of a representative sample of S&P 500 companies grant performance-based vehicles as part of their long-term incentive plans as of 2021); *see also* Andrea Pawliczek, *Performance-Vesting Share Award Outcomes and CEO Incentives,* 96 ACCT. REV. 337 (2021) ("As of 2014, about 60 percent of S&P 1500 companies granted some form of performance-based equity awards"). These studies describe performance-based incentive awards, which may often, but not always, be included in the incentive-based compensation affected by this rulemaking. For example, as described in Section II.C.2.a.iii, incentive-based compensation would not include awards based on nonfinancial events, such as opening a specified number of stores, and it would include cash awards based on satisfaction of a performance target that is based on a financial reporting measure even if the performance target was not pre-established or communicated, or the outcome was not substantially uncertain.

393 The three most common performance metrics used by the representative sample of the S&P 500 companies in long-term incentive plans were relative TSR (74%), return measures (46%), and earnings per share (31%). *See* Meridian Report. An alternative sample of firms, including smaller and foreign firms, yields slightly different results. Based on Commission staff analysis of 145 randomly sampled issuers drawn from the full population of issuers that filed an annual proxy statement in calendar year 2021, we estimate that approximately 42% of proxy statement filers used stock price and/or TSR as an element of their incentive-based compensation. Staff manually examined the CD&A in each of the 145 proxy statements to identify issuers that disclosed the use of stock price and/or TSR as compensation performance metrics in 2021. For purposes of this analysis, TSR may refer to relative TSR as well as TSR. This estimate is broadly consistent (*see* Scott Allen, *et al*., *The Latest Trends in Incentive Plan Design as Firms Adjust Plans Amid Uncertainty*, HUMANCAPITAL/AON BLOG (Oct. 2020), *available at* https://humancapital.aon.com/insights/articles/2020/the-latest-trends-in-incentive-plan-design-as-firms-adjust-plans-amid-uncertainty (indicating, in Figure 9, that TSR is the most commonly used metric in the CEO's long-term incentive plan among S&P 500 companies in most industries, where the use of TSR ranges from 22% to 61% of companies depending on the industry). *See also* comment letter from CEC 2,

The incidence of events where incentive-based compensation would be required to be recovered is affected by the number of restatements. One report indicates that 4.8% of companies disclosed a restatement in 2020.[394] As discussed above, both "Big R" and "little r" restatements may trigger compensation recovery analysis under the final rules.[395] As reported in the 2022 staff memorandum, we estimate that "little r" restatements may account for roughly three times as many restatements as "Big R" restatements.[396] Similarly, one recent study of accounting restatements between 2008 and 2015 identifies 634 "Big R" restatements and 1,653 "little r" restatements.[397]

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noting that in 2020, the average portion of equity awards tied to performance metrics (not including stock options) surpassed 50%, and that the average portion of at risk pay in a CEO's compensation package exceeds 80%.

394 *See* A Twenty-One Year Review. In 2021, the number of restatements was substantially higher due to Special Purpose Acquisition Company ("SPAC") restatements. Excluding SPAC restatements, there was a 10% year-over-year decrease in the number of restatements. *See* A Twenty-One-Year Review. Studies cited and data included in this release on "little r" restatement frequency may define "little r" restatements differently than the definition included in Section II, and are generally based on the total number of revisions to previously issued financial statements where the issuer did not file an Item 4.02 8-K. We note that one commenter observed that, "if Dodd-Frank section 954 were in place in 2009, executive officers at up to 674 companies would have been subject to the clawback provisions," *see* comment letter from Kovachev, 2015. The commenter cited Audit Analytics, 2009 Financial Restatements, A Nine Year Comparison. The number of restatements has substantially declined since 2009 to 338 in 2021, after excluding SPAC restatements, *see* A Twenty-One Year Review (non-SPAC restatements comprise 23% of the total 1,470 restatements). We note that another commenter observed that since the initial 2015 proposal, "improvements in checks and balances—such as board governance, audit committee oversight, and company systems of internal control over financial reporting—along with increased regulatory scrutiny by the SEC and PCAOB have occurred and act to help mitigate the likelihood of misstatements in financial statements filed with the Commission," *see* comment letter from CCMC (Nov. 22, 2021) ("CCMC 2").

395 *See* Section II.B.1.c. The following estimates are based on historical rates and types of restatements, which may not be indicative of future rates and types of restatements.

396 This estimate, based on exchange-listed companies during calendar year 2021, excluding SPACs, reflects approximately 54 "Big R" restatements and 173 "little r" restatements; including SPACs would have yielded 837 "Big R" and 474 "little r" restatements. These estimates were obtained from the Audit Analytics Restatement database which covers all Commission registrants who have disclosed a financial statement restatement in electronic filings since Jan. 1, 2000. To remove SPACs from the restatements, these calculations exclude blank check companies (SIC code 6770) and shell companies. SPAC restatements were excluded because they were unusually high in 2021 due to Commission guidance that year that SPACs account for their warrants as liabilities instead of equity, prompting a wave of one-time restatements.

397 These figures were provided in the 2022 staff memorandum. That memo also noted that "little r" restatements as a percentage of total restatements rose to nearly 76% in 2020, up from approximately 35% in 2005.

We note that not all accounting restatements will trigger a recovery of compensation that was earned as a result of meeting performance measures. Using incentive-based compensation tied to net income as an example, in order for that compensation to be required to be recovered, there would have to be an accounting error that increased net income. Based on one recent study, 60% of all "Big R" restatements made between 2008 and 2015 had a negative impact on net income, and only 25% of "little r" restatements had a negative impact on net income.[398] Thus, not every restatement would trigger a recovery of compensation that is tied to net income.[399] Also, we expect that recovery of incentive-based compensation that is tied to TSR would be relatively small and infrequent as a result of "little r" restatements, since these restatements are less likely to be associated with significant stock price reactions.[400]

The final rules will require exchanges to apply the compensation recovery requirement to all listed issuers, including EGCs, SRCs, FPIs, debt-only issuers, and controlled companies, with only limited exceptions. As outlined in the table below, we estimate that Rule 10D-1 would be applicable to approximately 5,364 registrants.[401] We estimate that, of those 5,364 registrants,

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398 *See* Choudhary *et al., supra* note 61. *See also* Thompson, *supra* note 79 (finding that 74% of "Big R" and 31% of "little r" restatements have a negative effect on net income); Christine Tan and Susan Young, *An Analysis of 'Little r' Restatements*, 29 ACCT. HORIZONS 667 (2015) (finding that 11.8% of "little r" restatements revise net income downwards).

399 Incentive-based compensation is more likely to be recovered if it is tied to more reported items on the financial statements. For example, incentive-based compensation tied to earnings or operating income is more likely to be recovered than incentive-based compensation tied to only revenue or only expenses. Between 2008 and 2015, approximately eight% of restatements involved expense recording (such as payroll or selling, general and administrative expenses). *See* Choudhary *et al., supra* note 61.

400 *See* Choudhary *et al., supra* note 61 (finding an average stock price reaction of -3.3% to "Big R" restatements and -0.3% for "little r" restatements); Thompson, *supra* note 79 (finding an average stock price reaction of -1.5% to "Big R" restatements and -0.3% for "little r" restatements).

401 We estimate the number of issuers subject to the final rule based upon Commission staff analysis of issuers that filed annual reports on Form 10-K, Form 20-F, or Form 40-F in calendar year 2021, regardless of the fiscal year of the filing, and that filed a proxy statement in 2021. The staff verified an issuer's Form 10-K to determine if the issuer is an SRC. The staff also checked an issuer's Form 10-K and registration statement to determine if the issuer is an EGC. The issuer's 12B status was used to identify exchange-listed companies. Staff determined an issuer's Section 12(b) registration status based, in part, on the self-reported status disclosed on the annual

there are 1,039 SRCs (that are not also EGCs), 160 EGCs (that are not also SRCs or FPIs),[402] 757 issuers that are both SRCs and EGCs, 722 FPIs (filing annual reports on Form 20-F), and 132 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 final rules.[403]

As described in the 2022 staff memorandum, compared to the baseline for the Proposing Release, in today's markets, many more companies have adopted compensation recovery policies.[404] For instance, one study of more than 17,000 companies from 1996 to 2017 reports that as of December 2017, 5,358 companies had a compensation recovery policy in place.[405] The rate of adoption may be higher among the larger U.S.-listed companies. Survey results indicate that 98% of a representative sample of S&P 500 companies have adopted compensation recovery

report cover page, as well as other determining factors such as the number or holders of record, the issuer's total assets, and the issuer's filing history of long- and short-form registrations (on Form 10-12 or Form 8-A12, respectively), deregistration filings (on Form 15), and delisting filings (on Form 25 or Form 25-NSE). 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.

402 We include the U.S. EGCs only (that are not also SRCs or FPIs) in our estimate. The total count of EGCs (that are not also SRCs) including U.S. EGCs, FPI EGCs, and MJDS EGCs (that are not also SRCs) was 434 based on 2021 registrant filings).

403 *See supra* note 41. Certain commenters describe the costs associated with compliance for registered management investment companies. We recognize that, in addition to internally managed funds, some externally managed funds may incur compliance costs if, for instance, they employ a chief compliance officer and include incentive based compensation as part of their pay package. *See, e.g.,* comment letter from ICI.

404 *See* 2022 staff memorandum.

405 Ilona Babenko, *et al*., *Clawback Provisions and Firm Risk* (working paper 2021), *available at* http://ssrn.com/abstract=4006661 (retrieved from SSRN Elsevier database) ("Babenko *et al*."). One commenter reports 100% of the S&P 500 companies, and 99.7% of the remaining 2,500 companies in the Russell 3000 index, have some form of compensation recovery policy, according to the ISS QualityScore database*, see* comment letter from the Office of the Comptroller of the State of New York. *See also* comment letter from CEC 2 (indicating based on an Oct. 2021 survey of their subscribers, more than 90% maintain a clawback policy, and citing a study finding that the number of large companies with clawback policies may be as high as 97%). As discussed below, we expect that most of these policies will require revision to meet the requirements in this rule. *See, e.g.,* note 413.

policies as of 2021,[406] and 83% of a representative sample of mid-cap (S&P 400) companies as of 2020.[407]

As outlined in the table below, we estimate that approximately 46% of all filers currently disclose some form of an executive compensation recovery policy.[408] We further estimate that approximately 34% of SRCs, 19% of EGCs, nine % of issuers that are both SRCs and EGCs, 25% of FPIs, and 13% 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)	2,451	5,364	46%
SRCs	352	1,039	34%
EGCs	31	160	19%
SRC and EGCs	71	757	9%
FPIs	178	722	25%
MJDS	17	132	13%
All other filers	1,804	2,554	71%

In addition to the issuers with company-specific executive compensation recovery policies, under the baseline there are existing provisions of law concerning the recovery of such compensation under certain circumstances, as well as certain disclosure requirements. Sarbanes-

406 *See* Meridian Report.

407 *See* Clearbridge Compensation Grp., *Executive Compensation Policies, The Clearbridge 100 Report for Mid-Cap Companies* (Dec 2020) *available at* https://www.clearbridgecomp.com/wp-content/uploads/CB100-Report-for-Mid-Cap-Companies-Exec-Comp-Policies-12-11-20.pdf ("Clearbridge Report").

408 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, *et al*.). In contrast to the analysis provided in the Proposing Release, we modified the keyword search because the searches identified issuers that disclosed they had *not* adopted or *were considering adopting*, compensation recovery provisions. Specifically, 3 out of 5,367 (0.6%) of companies did not file DEF 14A in 2021. We further eliminated 235 out of 5,364 (4%) of issuers flagged by the keyword search because the disclosures indicated the absence or consideration of compensation recovery provisions rather than their presence. 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.

Oxley Act Section 304 contains a recovery provision that is triggered when a restatement is the result of issuer misconduct. This provision applies only to CEOs and 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.[409] In addition, interim final rules under Section 111 of the Emergency Economic Stabilization Act of 2008 ("EESA") required institutions receiving assistance under the Troubled Asset Relief Program ("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, or other criteria were later found to be materially inaccurate.[410] As discussed above, relative to either the Sarbanes-Oxley Act or EESA, the compensation recovery requirement of the final rules has a different scope because it would affect any current or former executive officer of a listed issuer 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 officer in preparing the financial statements. Finally, we note that currently issuers other than SRCs, EGCs, and FPIs are required to disclose in their 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.[411]

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409 *See* 15 U.S.C. 7243.

410 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 Exchange Act. *See* Department of Treasury interim final rule, *TARP Standards for Compensation and Corporate Governance*, 74 FR 28394 (June 15, 2009).

411 *See* 17 CFR 229.402(b)(2)(viii).

Although there has been a large increase in the percentage of filers that disclose a compensation recovery policy since 2015,[412] recent studies indicate that these policies establish more limited circumstances in which a compensation recovery analysis would be triggered than would be the case under the final rules.[413] Many of the issuers that disclose having recovery policies require misconduct on the part of the executive officer to trigger recovery. For instance, a recent study reports that 52 out of 98 firms with misstatements and compensation recovery provisions required the employee to have contributed to the restatement with fraudulent actions or misconduct, whereas 46 of the 98 do not explicitly require fraud or misconduct as a condition of the recovery.[414] By contrast, the final rules would require a listed issuer to have a recovery policy that applies to "Big R" and "little r" restatements, without regard to misconduct.

There appears to be considerable variation in the coverage of executive officers subject to recovery under currently disclosed recovery policies.[415] Under the final rules, a listed issuer's

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412 *See* 2022 staff memorandum.

413 *See, e.g.*, Tor-Erik Bakke *et al*., *The Value Implications of Mandatory Clawback Provisions* (working paper June 28, 2018), *available at* https://ssrn.com/abstract=2890578 (retrieved from SSRN Elsevier database) (as of 2014-2015, only 5% (43 of 1,123) of companies with a voluntarily adopted compensation recovery policy have policies that are comparable to the Proposing Release); *see also* Meridian Report and ClearBridge Report. *Cf.* Erkens *et al*., *supra* note 62 (developing a "Clawback Strength Index," and finding that adopters of stronger policies experience more benefits).

414 *See* Thompson, *supra* note 78. Similarly, according to a study of a representative sample of S&P 500 companies, 53% of compensation recovery policies are triggered by financial restatements without requirement of ethical misconduct, regardless of cause, *see* Meridian Report. In addition, Babenko *et al*. (finding that 69% of compensation recovery policies specify that recovery applies only to persons directly responsible for the triggering event, and that 63% of companies have a disclosed "statute of limitations" for the recovery policy that is less than three years). In an earlier study of 2,326 companies in the Corporate Library database, DeHaan *et al*. *supra* note 62 find that 39% had compensation recovery policies that did not require executive misconduct in order to be triggered.

415 As of 2021, approximately 60% of a representative sample of S&P 500 companies had recovery policies that applied to current key executives (*e.g.*, Section 16 officers); approximately 23% applied to all incentive (annual and/or equity) plan participants; approximately 13% applied to current and former key executives (*e.g.*, Section 16 officers); and the remaining 4% applied to current named executive officers only. *See* Meridian Report. *See also* Shearman & Sterling, *Corporate Governance & Executive Compensation Survey 2021* (2021), *available at* https://www.shearman.com/Perspectives/2021/11/Shearman-Releases-19th-Annual-Corporate-Governance-and-Executive-Compensation-Survey (reporting similar results from a survey of the 100 largest U.S. public companies) ("S&S Report"). One commenter estimated that the rule may cover approximately 50,000

compensation recovery policy will require recovery of erroneously awarded compensation received after an individual began serving as an executive officer of the issuer during the recovery period. As a result, in some cases, recovery will 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. By contrast, most of the issuer-specific executive compensation recovery policies do not apply to former executive officers. For example, in a representative sample of firms from the S&P 500, only 13% of executive compensation recovery policies would apply to former executive officers as well as current executive officers,[416] and a study of mid-cap companies reports that 19% of executive compensation recovery policies would apply to former executive officers.[417] Therefore, according to recent studies, the majority of issuers disclose having recovery policies that require compensation recovery from a narrower range of individuals than a recovery policy that would comply with the final rule requirements.

While recent studies have shown that many issuers' current recovery policies differ from the requirements of the final rules, certain aspects of currently disclosed recovery policies are generally consistent with the final rules. For example, in a representative sample of firms from the S&P 500, 98% of issuers that disclosed recovery policies indicate that both cash and equity incentives would be included in the policy.[418] Also, most mid-cap issuers (74%) specified a

executives, if there are on average ten executive officers subject to recovery provisions at each issuer subject to Rule 10D-1. *See* comment letter from Fried. Although in some cases, there may be many affected executive officers, we expect that the number of affected executive officers will vary depending on several factors, including the structure of the issuer and its history of executive turnover.

416 *See* Meridian Report. *See also* S&S Report.

417 *See* Clearbridge Report.

418 *See* Meridian Report. Similarly, a study of the largest 100 U.S. public companies shows that 79 of the 95 companies that maintain a compensation recovery policy may recoup both cash and equity incentives (*see* S&S

look-back period of three years.[419] Thus a number of issuers with disclosed recovery policies include compensation scope and look-back provisions that may be consistent with the requirements under the final rules.

In summary, many issuers have voluntarily adopted compensation recovery policies. However, studies suggest that there may be substantial gaps between those voluntarily adopted policies and the new requirements, particularly with respect to inclusion of former executive officers, the events that would trigger recovery analyses, and the "no-fault" nature of the final rules.

B. Analysis of Potential Economic Effects

The final rules require exchanges and associations to establish listing standards that will require each issuer to implement and disclose a policy providing for the recovery of erroneously awarded incentive-based compensation. Consistent with Section 10D, the final rules 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.[420] The final rules are predicated on the premise that an executive officer should not retain compensation that, had the issuer's accounting been done properly in the first instance, would never have been received by the executive officer, regardless of any fault of the executive officer for the accounting errors. One benefit of the rule is that it will effectively return the erroneously awarded compensation to issuers and shareholders. In

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Report), and a study of midcap companies shows that 95% of companies with a compensation recovery policy would include the annual cash bonus and 90% would include PSUs (*see* Clearbridge Report).

[419] *See* Clearbridge Report.

[420] The set of relevant restatements includes those that correct errors in previously issued financial statements that are material to those previously issued financial statements or that would result in a material misstatement if the errors were corrected in or left uncorrected in the current report. *See* Section II.B.1.

addition, the rule may reduce the likelihood of accounting errors because executive officers—insofar as they have the ability to affect financial reporting—may have an enhanced incentive to ensure that greater care is exerted in preparing accurate financial reports, and a reduced incentive to engage in inappropriate accounting practices for the purpose of increasing incentive-based compensation awarded to them.[421] While these incentives could result in higher-quality financial reporting[422] that would benefit investors, they may also distort capital allocation decisions.

The requirement that an issuer implement a recovery policy may introduce uncertainty about the amount of incentive-based compensation the executive officer will be able to retain.[423] As a result, executive officers may demand that incentive-based compensation comprise a smaller portion of their compensation packages, or that they receive a greater total amount of compensation, to adjust for the possibility that the awarded incentive-based compensation may be reduced due to future recovery. And to the extent that executive officers respond negatively to the expected effects of the compensation recovery policies developed and implemented by issuers, the final rules may cause affected issuers to be less able to attract and retain executive talent. But we expect that investors may benefit to the extent that incentive based compensation will become more sensitive to the true performance of the issuer, which would better align the interests of the executive officers with those of the shareholders.

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[421] We recognize that some of the executive officers affected by the amendments may not have the ability to directly affect the financial reporting of the issuer.

[422] For purposes of this economic analysis, high-quality financial reporting means that the financial disclosure is informative about the actual performance and condition of the issuer, and should be informative about its value.

[423] The recovery policy would require listed issuers to recover excess compensation paid, but it would not require them to provide additional payment to executive officers in cases where a restatement would have resulted in a greater amount of compensation. We recognize that, absent any requirements and under the baseline, issuers may voluntarily compensate executives under such circumstances. But if executives are not compensated when a restatement would have resulted in a greater amount of compensation, this asymmetry may further reduce the value executive officers place on compensation subject to such a recovery policy.

Thus, as previewed above and discussed in more detail below, the final rule may produce both benefits and costs for the affected parties. Economists have analyzed the effects of the benefits and costs of issuer compensation recovery policies on issuer valuation. Specifically, one study analyzed the stock price reactions to the issuance of the Proposing Release and a second study examined stock price reactions to the adoption of voluntary compensation recovery provisions. The studies find, with certain caveats and limitations, positive average stock price reactions to the announcement of the events – whether the proposal of the regulations, or a particular issuer's adoption of voluntary compensation recovery provisions.[424] These stock price reactions indicate that market participants have assigned an overall positive value to the adoption of such provisions, leading to the observed increase in stock price on the date of the announcement.[425] These results support the inference that the benefits associated with adoption of compensation recovery provisions may justify the costs.[426]

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[424] We note that the events studied may reflect the expectation and adoption of less stringent recovery provisions than required by the new rules. The studies report that issuers with more powerful management teams (*see* Bakke *et al*.) and issuers with previous restatements (*see* Iskandar-Datta *et al*.) experience larger economic gains associated with the Proposing Release and the adoption of voluntary recovery provisions.

[425] There are certain limitations on these event studies. The results reflect market participants' response to the new information released in the event, relative to the expectations prior to the event. As a result, the positive market reaction to the Proposing Release reflects the difference between expectations and the actual proposing release. We also note that the observed stock price reaction to individual issuer's adoption of compensation recovery provisions would reflect the benefits associated with the specific provisions adopted by those firms, which were likely tailored to the issuer's needs and also unlikely to fully comply with the new rules.

[426] Bakke *et al*., *supra* note 413, find that issuers without a compensation recovery provision experienced positive abnormal returns of 0.6% on average around the announcement of the Proposing Release, relative to issuers with an existing compensation recovery provision. These results suggest that the effects of the proposed rules would provide a net benefit to issuers that do not have a compensation recovery provision, but that the aggregate benefits of the rulemaking would be reduced due to the increase in issuers with compensation recovery provisions in place. More broadly, there is evidence regarding the benefits to issuers of adopting compensation recovery provisions. *See, e.g.*, Mai Iskandar-Datta and Yonghang Jia, *Valuation Consequences of Clawback Provisions*, 88 ACCT. REV. 171 (2013) (finding that shareholders of issuers that adopt voluntary recovery provisions experience statistically significant positive stock-valuation consequences ranging between 0.79% and 1.23%, and that issuers with previous financial restatements had the largest gains).

The discussion below analyzes the economic effects of the final rules, 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 direct effects of the final rule on issuers and shareholders. We also discuss the effects on U.S. exchanges and discuss the costs of recovery. We then examine the indirect effects the final rule may have on financial reporting and executive compensation. We analyze the expected effects of the rule's disclosure requirements, as well as the effects from the rule's provisions on indemnification and insurance. Finally, we note that these effects may differ for different types of issuers.

1. Direct Effects on Issuers and Shareholders

The most immediate outcome of the final rules will be the establishment of listing standards that will result in issuers implementing recovery policies consistent with Section 10D.[427] Such recovery policies, when triggered, will provide a direct benefit for a listed issuer as well as its shareholders, when the company recovers incentive-based compensation that was erroneously paid to current or former executive officers. The recovered amounts will be available for the issuer to return to investors or invest in productive assets to generate value for shareholders.[428] Thus when erroneously awarded compensation is recovered, the recovered amounts will directly benefit issuers and shareholders.

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[427] Although, as described in the baseline section, many issuers have already implemented recovery policies that may be somewhat consistent with the final rule requirements, we recognize that most of the existing recovery policies will require revision to comply with the listing standards.

[428] Given the number of affected issuers and size of executive compensation packages, the amount of compensation recovered by issuers under the policies could be substantial. Although recovery of erroneously paid

We also expect a number of direct costs for issuers resulting from the final rules. To ensure that issuers have a recovery policy that meets the final rule requirements, issuers will likely incur legal and consulting fees to develop or revise recovery policies, and to modify the compensation packages of executive officers to conform to those policies. We expect that these costs may decrease over time, after initial development.

We have received several comment letters describing direct implementation costs. For example, several commenters have noted that even those issuers that already have recovery policies would likely incur some costs to revise those policies to comply with the final rule requirements.[429] One commenter indicated that issuers will likely incur significant costs including legal fees and litigation risks because they will need to revise existing policies.[430] Another commenter indicated that existing recovery plans include restrictions that may prohibit or restrict amendments to those plans, and noted that plan participants, particularly those no longer employed by the issuer, may not consent to an amendment that results in significant economic costs to themselves.[431] We acknowledge that issuers will incur direct implementation

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compensation would provide an immediate benefit for issuers and shareholders, these funds may not be large relative to the issuer's business operations. Based on an analysis of executive compensation using Standard & Poor's Compustat and Executive Compensation databases, in fiscal year 2020 non-salary compensation for all named executive officers combined was 0.7% of net income, and 0.44% of its market value of equity. This represents an upper bound for the amount of incentive-based compensation for named executive officers. These ratios do not include current and former executive officers that would be covered by the final rule but are not named executive officers.

[429] *See, e.g.,* comment letter from CEC (noting that the rules would impose additional implementation costs and require issuers to adjust their policies); Davis Polk 3 (noting that issuers will incur compliance costs associated with formulating recovery policies and modifying them over time); and Pay Governance (noting that the new rules will require substantive changes to many existing compensation recovery policies). *See also* comment letter from FedEx Corporation (Nov. 22, 2021) (noting that publicly traded corporations that adopted compensation recovery provisions based on the proposed rule issued in 2015 would incur implementation costs to adapt to the expanded scope of the final rule).

[430] *See* comment letter from Bishop (stating that issuers that have adopted recoupment policies specifying the "3-year period preceding the date on which the issuer is required to prepare an accounting restatement" will likely incur significant costs, such as legal fees and litigation risks because the rule specifies "three completed fiscal years immediately preceding the date the issuer is required to prepare an accounting restatement").

[431] *See* comment letter from SCG 1.

costs, and recognize that even those issuers that have implemented recovery provisions will likely incur costs to revise them and those costs will likely be higher for issuers that have implemented recovery plans with restrictions that prohibit or restrict amendments to those plans. 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, and may be initially substantial in a number of cases. However, as stated above, we expect once issuers adopt a recovery policy or revise their existing recovery policy, these costs may decrease over time. We also note that issuers will have additional time between adoption of these rules and exchange listing standards implementing the rules to amend any contracts to accommodate recovery.

2. Effects on U.S. Exchanges and Listings

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 final rules. 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 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 small as exchanges likely already have robust compliance tracking systems and personnel that are dedicated to ensuring listing standards are met.[432] 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 final rules and delist the issuer

[432] *See* comment letter from NYSE, supporting the approach to delisting in the Proposing Release, and describing the existing functions of exchange personnel.

for noncompliance. This would also result in a loss of the revenue from listing if the issuer were ultimately delisted.[433]

One commenter specifically requested an economic analysis addressing whether the rule will create conditions that will lead to a decrease in the number of U.S. public companies.[434] While we recognize that the rules are associated with costs for listed issuers, we also recognize and describe the benefits for listed issuers associated with the rules. In light of the significant uncertainty regarding the net effects for issuers, it is unclear whether the net effects of the rules would lead to a decrease in the number of issuers listed on U.S. exchanges.

In the event that issuers alter their decisions regarding where to list due to the final rules, 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 final rule to securities listed on U.S. exchanges, we do not believe it is likely that the final rule requirements would compel a typical issuer in the short-term to find a

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[433] If an issuer chooses to delist or is delisted by the exchange or association, the issuer's securities may become less liquid in the U.S. market, and the issuer's share price may be negatively affected. For issuers that fail to adopt or implement a recovery policy, delisting under the rule would be expected to increase the issuer's cost of capital. We also note that other factors may affect the decision for an issuer to delist and any effect from the final rules would be incremental to these other factors.

[434] *See* comment letters from CCMC (noting that the number of public companies has steadily declined to the point that it is half what it was in 1996, and that a similar rate of decline in the number of IPOs occurred concurrently, while the same period experienced the explosion of the size of the proxy and emergence of disclosure overload issues). *See also* comment letter from NACD (noting that the rule might have a dampening effect on the market for public companies themselves if it and other rules like it influence private companies to remain private or push public companies to go private).

new trading venue not subject to these requirements.[435] The final rules 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 final rule requirements, choose to forgo listing or delay listing until the issuers' circumstances change.[436] The magnitude of this effect on exchanges and issuers 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 time, thus having lasting impact on the exchanges' revenue. Finally, the final rules apply to issuers who list securities on a national securities exchange. As such there are unlikely to be competitive effects among national securities exchanges due to all national securities exchanges being affected by the final rule requirements.

3. Costs of Recovery

We recognize that, as a result of this rulemaking, issuers will face costs to calculate the amount to be recovered should an event trigger the compensation recovery provision. The calculations could be done internally or the issuer could choose to retain an outside 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 issuers' compensation structure, the type of compensation involved, the periods affected, and the method selected for calculation.

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[435] We note that changes in laws in foreign jurisdictions regarding compensation recovery after the publication of the final rules in the Federal Register could potentially reduce the relative value of a U.S. listing. We also note that the revenue effect on U.S. exchanges resulting from the behavior of FPIs is unclear, because while some FPIs may choose to delist as a result of the final rules, it is at least theoretically possible that others may choose to list because of them. Although issuers can voluntarily adopt compensation recovery provisions without listing on a U.S. exchange, the decision to list on a U.S. exchange after the adoption of the final rule would reflect a stronger commitment to enforcing such provisions. *See* Section IV.B.8.

[436] We note that capital formation could be hindered if an issuer chooses to forgo or delay listing because of the final rules 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 final rules would be incremental to these other factors.

The costs of calculating an amount to be recovered are expected to be higher when incentive-based compensation that is based on stock price or TSR is subject to recovery. In this context, issuers will need to determine the amount of compensation that was erroneously awarded based on the extent to which an inflated stock price results from an accounting error. One key input for such calculations would be the difference between the historical stock prices and the "but for" stock price, where the "but for" stock price is the price at which the security would have sold, absent the accounting error. This section provides background information on methods to estimate the amount of inflation in stock prices as a result of accounting errors.

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.[437] One such method, which is often used in accounting fraud cases to determine the effects of restatements 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[438] that restated financial information is required, separate from any change in the stock price due to market factors.[439] An event study therefore measures the net-of-market drop in the stock price, 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

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[437] 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.

[438] 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.

[439] Note that the "announcement" may take a variety of forms. For instance, an analyst or reporter may publicly disclose information about the company that serves as a corrective disclosure, even if the company does not make an announcement. In addition, since companies would generally not issue a Form 8-K release for a "little r" restatement, the publication of revised financials may serve as a public disclosure.

net-of-market drop in the stock price, certain decisions need 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.[440] 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.[441]

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.[442] Because certain executive officers may have influence over the timing of the release of issuer-specific information, they may have the ability to affect the estimation of a reasonable "but for" price. For example, if an accounting restatement is expected to have a negative effect on an

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[440] 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* Mark L. Mitchell and Jeffrey M. Netter, *The Role of Financial Economics in Securities Fraud Cases: Applications at the Securities and Exchange Commission*, 49 BUS. LAW 565 (Feb. 1994); S. P. Kothari and Jerold B. Warner, *Econometrics of Event Studies* (B. Espen Eckbo ed.), HANDBOOK CORP. FIN. EMPIRICAL CORP. FIN vol. I (Elsevier/North-Holland 2004); and John Y. Campbell *et al*., THE ECONOMETRICS OF EVENT STUDIES, Princeton University Press (1997).

[441] Issuers may conduct event studies of restatement effects for a variety of reasons, including the possibility of shareholder litigation and government investigations. If an issuer has already conducted an event study to estimate the amount of inflation in the stock price due to a restatement, that would reduce the costs of conducting an event study for purposes of compensation recovery analysis while also limiting the latitude associated with utilizing different design choices.

[442] 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 economy, and information about expected inflation).

issuer's stock price, certain executive officers may have an incentive and 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 the board of directors to evaluate the effect of the restatement on the stock price.

As discussed above, the final rules do not require an event study to calculate a reasonable estimate of the erroneously awarded compensation tied to stock price to be recovered after an accounting error leading to a restatement. Instead, the final rules permit an issuer to use any reasonable estimate of the effect of the restatement on stock price and TSR. In addition, we note that an issuer may 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 final rules. In choosing a methodology to derive a reasonable estimate of the effect of the accounting restatement on stock price and TSR, issuers would likely weigh the costs of implementing any methodology and the potential need to justify that estimate, under their unique facts and circumstances. We have received a number of comments regarding the costs of calculating the recoverable amount. For example, some commenters noted that determining the amount of compensation that was based on or derived from the financial reporting measure may be challenging because incentive compensation award amounts may include multiple metrics, and reflect judgment and discretion rather than a formulaic calculation.[443] In addition, commenters indicated that the calculations will expose managers and boards of directors to litigation risk.[444]

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443 *See* comment letters from Chevron; Coalition; Osler; and TELUS.

444 *See, e.g.,* comment letters from Chevron; and Coalition. To the extent that issuers perceive more costly estimation methods to be a preferred approach in the context of potential litigation, the risk of litigation may increase the costs of compliance with the final rules.

Commenters have also noted that issuers will face additional costs associated with estimating the amount of incentive-based compensation when the compensation is linked to stock price and TSR because of the complexity of the calculations.[445] A number of commenters requested additional guidance and examples of calculations,[446] and some expressed concern that issuers may consider moving away from TSR-based incentive plans to avoid the potential costs and uncertainty that may result should a recovery be triggered.[447] Some commenters noted that there would be increased litigation risk regarding recoveries of compensation linked to stock price and TSR due to the potential range of reasonable estimates.[448]

Since there is considerable variation in incentive compensation plans as well as restatements, and in addition, issuers may choose different reasonable approaches to calculation, we cannot estimate the total costs of calculating the amounts to be recovered. Nor can we estimate the likelihood that companies will move away from TSR-based incentive plans.[449] These uncertainties also may undermine issuers' incentives to enforce their recovery policies and

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445 *See, e.g.,* comment letters from CAP; CEC 1; Chevron; Compensia; NAM; SH&P (stating that incentive compensation based on performance metrics such as stock price or total shareholder return cannot be accurately recalculated); Pearl Meyer; Davis Polk 1; and Kovachev. For example, CAP noted that estimates of the impact of the restatement when stock price/TSR metrics are involved, "will be extremely difficult to put into practice and will force Boards to hire outside experts to perform the calculations. We predict that this will benefit professional service firms willing to perform the analyses, but will return little value to shareholders."

446 *See, e.g.,* comment letters from Chevron; Compensia; Hay Group; Pay Governance; Pearl Meyer; and WAW.

447 *See* comment letters from Compensia; and WAW.

448 *See, e.g.,* comment letters from Chevron; Coalition; Compensia; IBC (stating "[o]ften [the methods] produce ranges of numbers, rather than a definite amount, introducing more uncertainty and opportunity to second guess the company's decision on how much to recover, therefore opening the door for potential additional shareholder derivative litigation"); and Pearl Meyer (noting the possibility of challenges from interested parties, including current executive officers as well as individuals who were executive officers at some point during the lookback period but are no longer holding such position).

449 *See* Section IV.B.5 for additional discussion of the economic effects of the potential decision to move away from incentive based compensation that is subject to recovery, such as TSR-based incentive plans.

make it more difficult for exchanges to monitor compliance.[450] 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 issuers to carefully document the considerations that went into the determination to enforce (or not enforce) their recovery policy.

Although the costs of hiring outside experts may vary depending on the circumstances, we estimate that if outside professionals are retained to assist with the calculations, they will likely charge between $80 and $1,800 per hour for their services.[451] One commenter indicated that the expert fees will be closer to $800 per hour when determining the impact of an accounting restatement on stock price or TSR.[452] Another commenter indicated that the cost of an event study may range from $100,000 to $200,000.[453]

We acknowledge the costs and the potential complexity associated with calculating amounts to be recovered and acknowledge that the hourly rate may exceed its estimated values in some cases, depending on the complexity of the calculations. In addition, we recognize the

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450 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 erroneously awarded compensation required to be recovered. This may make it more difficult for exchanges to monitor compliance.

451 The range is based on comment letters from TCA and Davis Polk 1 as well as the SEAK, Inc., 2021 Survey of Expert Witness Fees report indicating that the hourly fee for case review/preparation ranges from $80 to $1,800 with an average fee of $422 per hour. *See* SEAK, Inc., *2021 Survey of Expert Witness Fees*, SEAKEXPERTS.COM BLOG (July 25, 2022, 3:54 PM), *available at* https://blog.seakexperts.com/expert-witness-fees-how-much-should-an-expert-witness-charge/#:~:text=According%20to%20SEAK%27s%202021%20Survey,experts%20responding%20is%20%24500%2Fhour. We note that this range is also roughly consistent with the 90th percentile of wage information compiled by the U.S. Bureau of Labor Statistics, Occupational Employment Statistics for the Financial and Investment Analyst occupation. As of May 2021, the median hourly wage for a financial and investment analyst was $44.03 and the 90th percentile hourly wage was $80.08.

452 *See* comment letter from TCA.

453 *See* comment letter from Davis Polk 1 (citing a study by Marsh & McLennan Companies).

likelihood of higher costs associated with the recovery calculations for incentive-based compensation linked to stock price and TSR as well as the widespread use of this type of incentive-based compensation.[454] However, we are adopting the new rule and rule amendments to implement the statutory mandates of Section 10D, which is intended to require the return of executive compensation that was awarded erroneously to the issuer and its shareholders. The costs of calculating amounts to be recovered may be mitigated as issuers exercise flexibility to determine the method of calculation that is most appropriate given the circumstances. Also the costs of calculating recovery amounts may be lower to the extent that the calculations would have been performed in the context of the restatement, because the effect of the misstatement on management's compensation is a qualitative factor in a materiality analysis.[455]

Depending on the circumstances, there may be other costs associated with enforcing the mandatory recovery policy. If the current or former executive officer is unwilling to return erroneously awarded compensation, the issuer may incur legal expenses to pursue recovery through litigation or arbitration.[456] However, if the direct expense paid to a third party to assist in enforcing the recovery policy from an executive or former executive officer would exceed the erroneously paid incentive-based compensation, the final rules allow the issuer, under certain circumstances, to determine that recovery would be impracticable, and therefore not pursue the recovery. This may mitigate the direct costs of enforcement to issuers.[457] Finally, if an issuer

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454 *See supra* note 393.

455 See *supra,* note 80.

456 Issuers may incur additional costs associated with the rules to the extent that they create an impediment to litigation settlements because they do not include an exception for releases of potential recoupment claims. This may impose costs directly on issuers and indirectly on the economy as litigation could potentially be prolonged. *See, e.g.,* comment letter from SCG 1.

457 Since the final rule will permit issuers to forgo recovery from tax-qualified retirement plans, we expect that issuers and plan participants will avoid the costs associated with such recovery.

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.

4. 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 assessment of the issuer's performance and should be informative about its value. Erroneous financial reporting can mislead investors about the issuer's value. For instance, improper financial reporting may overstate demand for the issuer's products, or exaggerate its ability to manage costs. 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. For example, in some instances, executives might have incentives to pursue impermissible accounting methods under GAAP that result in a material misstatement of financial performance, to realize higher compensation.[458] This potential for *deliberate* misreporting reflects a principal-agent problem that is detrimental for

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

shareholders.[459] Although civil and criminal penalties already create disincentives to deliberate misreporting, the recovery requirements under the final rules will 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 will depend on the particular circumstances of an issuer.

The final rules may also provide executive officers with an increased incentive to take steps to reduce the likelihood of *inadvertent* misreporting.[460] Most directly, because executive officers are less likely to benefit from reporting errors, they have stronger incentives to increase the amount of time and resources they spend on the production of high-quality financial reporting, and may also, for instance, increase the staffing of the internal audit function.[461] These actions would reduce the likelihood of an accounting error that requires restatement.

Research studies provide mixed results on the impact of compensation recovery on financial reporting accuracy and reliability. Several studies have analyzed outcomes after the

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[459] Among other decisions, executive officers 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 and condition of the issuer. To the extent 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, executive officers 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 officer's incentive to allocate the appropriate amount of resources to produce high-quality financial statements, which reduces the information value of financial reporting. In addition, the issuer may not realize all of the benefits from high quality financial reporting. For example, accurate financial reporting by one issuer provides a useful benchmark to investors in evaluating other issuers. As a result, issuers may underinvest in the production of high-quality financial statements, relative to the benefits for investors.

[460] One commenter noted while intentional reporting errors are relatively infrequent between 1996 and 2005 (1% error rate), unintentional misstatements are far more frequent (2.89% error rate). *See* comment letter from Vivian Fang.

[461] *See, e.g.,* comment letters from NYCRS; Fried; and Public Citizen 1. We recognize that there may be some limit beyond which the utilization of additional resources in order to further limit the likelihood of small, inadvertent accounting errors may not be the optimal use of these resources. It is unclear where the current expenditures of issuers stand relative to these limits. We also recognize that financial reporting decisions may be outside of the scope of responsibilities of some of the executive officers who will be subject to compensation recovery as a result of the final rules, *see* Section II.C.1.

implementation of a voluntary recovery policy, finding results that are consistent with issuers devoting more resources to internal control over financial reporting.[462] In addition, some studies show that adoption of voluntary recovery provisions is associated with improved managerial decision making.[463] However, we acknowledge that multiple studies find that the adoption of recovery provisions may lead to outcomes such as real earnings management to achieve short-

[462] *See* Michael H.R. Erkens *et al., Not All Clawbacks Are the Same: Consequences of Strong Versus Weak Clawback Provisions,* 66 J. ACCT. & ECON. 291 (2018) (finding that companies that voluntarily adopt stronger clawback measures experience improvements in reporting quality); Lillian H. Chan *et al., The Effects of Firm-Initiated Clawback Provisions on Earnings Quality and Auditor Behavior* 54 J. ACCT. & ECON. 180 (2012) (finding that after the adoption of clawback provisions, incidence of accounting restatements declines, firms' earnings response coefficients increase, and auditors are less likely to report material internal control weaknesses, charge lower audit fees, and issue audit reports with a shorter lag); DeHaan, *et al*., *supra* note 62 (finding improvements in financial reporting quality following clawback adoption, including decreases in meet-or-beat behavior and unexplained audit fees, a decrease in restatements, a significant increase in earnings response coefficients and a significant decrease in analyst forecast dispersion). *See also* Henry K. Mburu and Alex P. Tang, *Voluntary Clawback Adoption and Analyst Following, Forecast Accuracy, and Bias,* 18 J. ACCT & FIN. 106 (2018) (finding that voluntary adoption of compensation recovery provisions leads to an increase in analyst coverage and analyst accuracy, as well as reduced optimistic bias by analysts); Mark A. Chen *et al*., *The Costs and Benefits of Clawback Provisions in CEO Compensation,* 4 REV. CORP. FIN. STUD. 108 (2015) (finding lower earnings variability and reduced aggressiveness in financial reporting after voluntary adoption of a compensation recovery provision); Bradley Benson *et al*., *Will the Adoption of Clawback Provisions Mitigate Earnings Management?,* 18 J. ACCT. & FIN. 61 (2018) (finding that when compensation recovery provisions are implemented by a company with an independent board, earnings quality improves).

[463] *See, e.g.*, Yu-Chun Lin, *Do Voluntary Clawback Adoptions Curb Overinvestment?,* 25 CORP. GOVERN. INT'L REV. 255 (2017) (finding that compensation recovery provisions mitigate overinvestment); Dina El-Mahdy, *The Unintended Consequences of Voluntary Adoption of Clawback Provisions on Managerial Ability,* 60 ACCT. & FIN. 2493 (2020) (finding that voluntary adoption of compensation recovery provisions is associated with an increase in productivity as measured by revenues generated for a given level of costs); Thomas Kubrick, Thomas Omer, and Zac Wiebe, *The Effect of Voluntary Clawback Adoptions on Corporate Tax Policy,* 95 ACCT. REV. 259 (2020) (finding that adoption of compensation recovery provisions may lead to more effective tax planning and lower effective tax rates); Anna Brown *et al*., *M&A Decisions and US Firms' Voluntary Adoption of Clawback Provisions in Executive Compensation Contracts,* 42 J. BUS. FIN. & ACCT. 237 (2015) (finding that adoption of compensation recovery provisions leads to improved decisions in the context of mergers and acquisitions); Matteo P. Arena and Nga Nguyen, *Compensation Clawback Policies and Corporate Lawsuits,* 27 J. FIN. REG. & COMPLIANCE 70 (2019) (finding that after the adoption of compensation recovery provisions, litigation risk significantly declines). One paper finds that firms' investment risk decreases with the voluntary adoption of a compensation recovery provision, but notes that this effect may be either value-increasing or value-decreasing, depending on the circumstances. *See* Yu Chen and Carol Vann, *Clawback Provision Adoption, Corporate Governance, and Investment Decisions,* 44 J. BUS. FIN. ACCT. 1370 (2017) (finding that after adopting a compensation recovery provision, firms' abnormal investment decreases and the firms' investments are less risky).

term earnings goals.[464] To the extent that the final rules lead some issuers to increase real earnings management, investors and issuers could bear increased costs.

Executive officers may also take other steps to reduce the likelihood of inadvertent misreporting. An executive officer could change the business practices of the issuer, thereby affecting the opportunity for an accounting error to arise. For example, an executive officer 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, which may reduce the likelihood of accounting errors. As another example, the executive officer could make accounting judgments on loan loss reserves that are less likely to result in an accounting restatement. 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

[464] *See*, for instance, Lilian Chan *et al*., *Substitution between Real and Accruals Based Earnings Management after Voluntary Adoption of Compensation Clawback Provisions,* 90 ACCT. REV. 147 (2015) (finding that the total amount of earnings management does not decrease after recovery provisions are adopted, and that companies are more likely to lower research and development expenses to achieve short term earnings goals after adoption). Similar results are provided by Gary Biddle *et al*., *Clawback adoptions, managerial compensation incentives, capital investment mix and efficiency*, (working paper Dec. 2021), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3042973 (retrieved from SSRN Elsevier database). A related paper, Dichu Bao *et al*., *Can Shareholders Be at Rest After Adopting Clawback Provisions? Evidence from Stock Price Crash Risk,* 35 CONTEMP. ACCT. RES., 1578 (2018), finds that voluntary recovery provision adoption is associated with an increase in stock price crash risk, that after the adoption some companies reduce the readability of their Form 10-K filings, and increase real earnings management through abnormal production costs, abnormal expenses, and abnormal cash flows. *See also* Hangsoo Kyung *et al*., *The Effect of Voluntary Clawback Adoption on non-GAAP Reporting,* 67 J. ACCT. & ECON. 175 (2019) (finding that issuers adopting recovery provisions increase the frequency of disclosure of non-GAAP earnings, and non-GAAP exclusion quality decreases after the adoption); Thompson, *supra* note 69 (finding that issuers with compensation recovery provisions are more likely to report misstatements as "little r" restatements instead of "Big R" restatements). Consistent with the possibility that the rules as proposed may create incentives to reduce research and development expenditures, Bakke *et al*., *supra* note 413, find that the stock price reaction to the Proposing Release was less positive for issuers with high cash flow activity and companies engaged in research and development activity, and it was negative for issuers that have already adopted a compensation recovery provision and are engaged in research and development. *See also* comment letter from Fried (noting the potential to incentivize executive officers "to shift from value-reducing earnings manipulation to even more destructive real earnings management").

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.[465]

As a result of the final rules, we believe that the increased incentives to generate high-quality financial reporting may improve the overall quality of financial reporting. For some issuers that are already producing high-quality financial reports, there may be limits to the benefits of incremental increases in financial reporting quality. However, we believe that a substantial number of issuers will benefit from an increase in the quality of financial reporting. These improvements 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.[466] While we lack the data to quantify the potential benefits to shareholders from a reduced likelihood of an accounting error, evidence suggests that penalties imposed by the market for accounting restatements can be substantial. For example, one recent study[467] found that over the period 2008 to 2015 the market value of equity of the

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[465] One academic study finds 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, issuers 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* Christopher S. Armstrong *et al*., *When Does Information Asymmetry Affect the Cost of Capital,* 49 J. ACCT. RSCH. 1, (Mar. 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* Patricia M. Dechow and Ilia D. Dichev, *The Quality of Accruals and Earnings: The Role of Accrual Estimation Errors,* 77 ACCT. REV. 35, (2002); and Jennifer Francis *et al*., *The Market Pricing of Accruals Quality* 29 J. ACCT. & ECON. 295, (2005).

[466] In addition, to the extent that investors cannot differentiate between issuers with high quality financial reporting and issuers with low quality financial reporting, they may underinvest in issuers with high quality financial reporting. But an improvement in the reporting of issuers with low quality financial reporting would raise the average issuer's quality of financial reporting. This improvement for the average issuer may mitigate the underinvestment in issuers with high quality financial reporting and therefore lower their cost of capital as well.

[467] *See* Choudhary *et al., supra* note 61. *See also* Christine E.L. Tan *et al*., *An Analysis of "Little r" Restatements,* 29 ACCT. HORIZONS 667 (2015) and Susan Scholz, *Financial Restatement: Trends in the United States: 2003−2012,* CENTER FOR AUDIT QUALITY, (July 24, 2014), *available at* https://www.thecaq.org/financial-restatement-trends-united-states-2003-2012.

average issuer declined by 3.3% upon announcement of a "Big R" financial restatement, and by 0.3% upon announcement of a "little r" restatement.

More broadly, the availability of more informative or accurate information regarding the financial performance of issuers may also have the effect of increasing the efficient allocation of capital among corporate issuers. Because investors will be better informed about the potential investment opportunities at any given point in time, they will 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 final 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 final rule requirements.[468] In contrast, without the final rules, 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 final rules are not without associated costs. Under the final rules, as a commenter asserted, the increased allocation of resources to the production of high-quality financial reporting may divert resources from other activities that may be value enhancing.[469] Moreover, while the increased incentive to produce high-quality financial reporting and thus reduce the likelihood of accounting errors should increase the informational efficiency of investment opportunities, it may also encourage, as a few

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468 *See* Brian J. Bushee *et al*., *Economic Consequence of SEC Disclosure Regulation: Evidence From the OTC Bulletin Board,* 39 J. ACCT. & ECON. 233 (2005).

469 *See, e.g.,* comment letter from NACD (noting the proposal could divert resources to financial reporting that would otherwise be used for other value enhancing activities).

commenters noted, executive officers to forgo value-enhancing projects if doing so would decrease the likelihood of a financial restatement.[470] For example, when choosing among investment opportunities for the issuer, executive officers may have an increased incentive to avoid those projects that would require more complicated accounting judgments, because such projects may be more likely to trigger a restatement.[471] That is, the final rules may reduce incentives for an executive officer to choose projects for which it is more difficult to generate high-quality financial reporting.[472] This could have a beneficial impact on the value of the issuer to the extent that the forgone projects would have resulted in lower value than those that were ultimately chosen.[473] The final rules may also be value-enhancing to listed issuers by reducing the likelihood of accounting errors because executive officers may be incentivized to ensure that

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[470] 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 a restatement. *See* Patricia M. Dechow *et al*., *Predicting Material Accounting Misstatements,* 28 CONTEMP. ACCT. RSCH. 17 (Spring 2011). Consistent with these findings that riskier operations are associated with an increased likelihood of restatements, Babenko *et al*. find that firms that adopt a recovery provision subsequently reduce their research and development spending, file fewer patents, and decrease their capital expenditures. The authors also find that firms adopting a recovery provision subsequently hold more cash, issue less net debt, and experience an increase in credit rating. *See, e.g.,* comment letters from Fried; NACD; and NAM.

[471] 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. *See* comment letter from NAM.

[472] *See* Babenko *et al*. The study finds that executives respond to the implementation of a compensation recovery policy by reducing firm risk. For example, the authors report that issuers spend less on research and development, and file for fewer patents. This is consistent with executives changing their project selection policy as the result of implementing a compensation recovery policy. 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.

[473] *See* Babenko *et al*. The authors address the question of whether the reduction in risk associated with the voluntary adoption of a compensation recovery policy is beneficial for shareholders. They find a positive and significant relation between adoption of such a policy and long-term stock and accounting performance and a positive and significant short-term stock-market reaction around the date of the adoption. The stock market response to compensation recovery policy adoption, as well as stock and accounting performance over the year subsequent to adoption, are significantly larger the greater the reduction in actual and predicted firm risk associated with the recovery provision. *See also* California Public Employees' Retirement System (Nov. 22, 2021) ("CalPERS 2") (noting that "clawback policies potentially mitigate excessive risk-taking that certain compensation may incentivize").

greater care is exerted in preparing accurate financial statements, thus avoiding the costs associated with a restatement.

As described above, some studies suggest that a compensation recovery policy could result in an increased likelihood of an executive officer 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.[474] For example, if an executive officer is under pressure to meet an earnings target, rather than manage earnings through accounting judgments, an executive officer 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.

Under the final rules, if it appears that previously issued financial statements may contain an accounting error, there would be a potential incentive for issuers or individual executive officers (to the extent they are in a position to do so) to cause the company to avoid characterizing the accounting error in such a way that would trigger application of the final rules. Such an incentive exists because compensation recovery is only required after the conclusion that an accounting restatement is required to correct an error in previously issued financial statements that is material to the previously issued financial statements or that would result in a material misstatement if the error were corrected in or left uncorrected in the current period. To the extent that these incentives discourage the timely and accurate reporting of material

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474 *See supra* note 464. *See also* Sohyung Kim *et al*., *Other Side of Voluntary Clawback Provisions in Executive Compensation Contracts: Evidence From the Investment Efficiency,* 25 REV. PACIFIC BASIN FIN. MKTS. & POLICIES 1 (2022) (finding evidence that the voluntary adoption of compensation recovery policies decreases the investment efficiency in the post-adoption period, especially for issuers whose *ex ante* probability of underinvestment is high).

accounting errors, it could result in loss of confidence in financial information disclosures by investors and hinder capital formation.

However, we note that there are serious consequences, including criminal penalties, that help to deter either a delay or mischaracterization. In addition, the rule discourages delays by defining the trigger date as the date on which the issuer concludes, or reasonably should have concluded, that the issuer's previously issued financial statements contain an error that requires a restatement. In addition, the inclusion of "little r" restatements eliminates the incentive to mischaracterize "Big R" restatements as "little r" restatements. Finally, oversight by audit committees and outside auditors may serve as an additional mitigating factor.

5. Effects on Executive Compensation

When setting the compensation for executive officers, 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.[475] The purpose of tying compensation to performance is to provide an incentive for executive officers to maximize the value of the enterprise, thus aligning their incentives with other shareholders. The proportion of the compensation 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 officer's risk aversion may make compensation packages with strong

[475] Executive compensation may be tied to issuer performance implicitly, as in the case of awards of options or restricted stock that have only service-based vesting conditions, or more explicitly, as in the case of incentive-based compensation with market or performance conditions that affect the amount of compensation or whether it vests.

performance incentives undesirable for the executive officer 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.[476]

Several commenters have indicated that the requirements of the final rules could meaningfully affect the size and composition of the compensation packages awarded to executive officers of listed issuers.[477] In particular, some commenters argued that the final rules would encourage executive officers to favor compensation that would not be subject to potential recovery, such as base salary, over incentive-based compensation.[478] The Commission acknowledges that the composition of executive compensation could be impacted by the final rules. On the one hand, the final rules could encourage greater use of certain kinds of incentive-based compensation. The implementation of a mandatory recovery policy may make it less costly for the issuer to use the types of incentive-based compensation that would be subject to recovery (those with explicit market or performance conditions tied to the issuer's financial reporting or stock price).[479] Most directly, such a policy would reduce the cost of such

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

[477] *See, e.g.,* comment letters from TCA; Ensco; WAW; NAM; CAP; NACD; and American Vanguard.

[478] *See, e.g.,* comment letters from American Vanguard, NAM, and WAW. Further, some commenters argued that the final rules would encourage the use of incentive-based compensation tied to performance measures that fall outside the scope of the rules, such as strategic measures, subjective measures, or operational measures. *See*, *e.g.*, comment letter from Ensco.

[479] This effect was observed in a recent study examining voluntarily adopted compensation recovery provisions. *See, e.g.*, Peter Kroos *et al*., *Voluntary Clawback Adoption and the use of Financial Measures in CFO Bonus Plans,* 93 ACCT. REV. 213 (2018) (finding that adoption of compensation recovery provisions is associated with greater CFO bonus incentives because such compensation recovery provisions serve as an effective check on the ability of CFOs to manipulate the performance metrics that could influence their performance-based compensation). The final 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 relative to voluntarily adopted recovery provisions.

compensation by recovering overpayments associated with misstatements. Further, adopting a recovery policy may reduce the potential incentives that may arise from incentive-based compensation to engage in practices resulting in inaccurate reporting.

On the other hand, as noted by some commenters, the final rules could discourage the use of certain kinds of incentive-based compensation. As noted at the beginning of this section, risk-averse executive officers prefer predictable compensation, and the mandatory implementation of a recovery policy that meets the requirements of the final rules would introduce an additional source of uncertainty in the compensation of the executive officer.[480] In addition, the expected value of executive compensation subject to the rule could decrease because, to the extent any such compensation is erroneously awarded, it must be recovered. Therefore, because incentive compensation based on financial metrics could be both more uncertain and lower in expected value, executives may seek a shift away from such compensation and towards base salary or other forms that are not recoverable, such as options or restricted stock with time-based vesting, incentive-based compensation tied to operational metrics, or bonuses awarded at the discretion of the board. To the extent these forms of compensation have reduced incentive alignment between executive pay and shareholder interests, *i.e.*, pay-for-performance sensitivity,[481] this potential shift in compensation composition, as noted by several commenters, may lessen the alignment with the interests of shareholders.[482]

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480 The "no-fault" nature of the recovery policy, which mandates that executive officers return erroneously awarded compensation even if they had no role in the accounting error, along with the issuer's choice of a calculation methodology and the variation in assumptions that underlie it could also add to this uncertainty.

481 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.,* Michael Jensen and Kevin Murphy, *Performance Pay and Top Management Incentives,* 98 J. POL. ECON. 225 (1990).

482 *See, e.g.,* comment letter from Davis Polk 3 (suggesting that decreasing the use of accounting-based incentive compensation by increasing base salary may weaken the alignment between executives' incentives and those of

We acknowledge this potential cost but believe a number of factors and findings mitigate this concern. First, as noted earlier in this section, the issuer, in contrast to the executive, has incentives to push for *more* incentive-based compensation. This is because erroneous payments can now be recouped, and incentive-based compensation will generate less temptation to manipulate financial metrics, potentially leading to more accurate reporting. Thus issuer incentives could offset executive desire to shift away from incentive-based compensation. Second, it is not obvious that a shift away from incentive-based compensation covered by this rule lessens the alignment with the interests of shareholders. Less incentive-based compensation reduces incentives for financial misreporting, contributing to more reliable financial statements, which benefits issuers and shareholders. In addition, recent evidence indicates some investor dissatisfaction with performance-based pay[483] as well as a growing interest in nonfinancial metrics pay.[484] Third, to the extent that financial reporting quality improves because of the rule and reduces the likelihood of a restatement, this may reduce the uncertainty in executive compensation resulting from the rule. Lastly, other factors, such as shareholder engagement, other governance controls, and market forces play an important role in the level and design of executive compensation and may mitigate changes due to the final rules.[485]

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the company and shareholders). *See also* comment letters from TCA; Ensco; Pearl Meyer; WAW; NAM; CAP; NACD; and American Vanguard.

[483] *See, e.g.*, Council of Institutional Investors, *Policies on Corporate Governance* § 5 Executive Compensation (rev. Mar. 7, 2022), *available at* https://www.cii.org/corp_gov_policies#exec.

[484] *See, e.g.*, ISS Governance, *2021 Global Benchmark Policy Survey* (Oct. 2021), *available at* https://www.issgovernance.com/file/publications/2021-global-policy-survey-summary-of-results.pdf (reporting that while there has been an upsurge in interest in environmental, social, and governance (ESG) metrics in executive compensation, some observers have criticized the increasing use of poorly defined ESG metrics).

[485] Recent regulatory changes have not always impacted executive compensation in ways that may have been expected, perhaps because of the offsetting effect of heightened investor engagement on pay structure since the introduction of say-on-pay votes. *See, e.g.*, Lisa De Simone, Charles McClure and Bridget Stomberg, *Examining the Effects of the TCJA on Executive Compensation* (Apr. 15, 2022). Kelley School of Business Research Paper No. 19-28, *available at* https://ssrn.com/abstract=3400877 (finding no evidence that the repeal of a long-standing

Separate from changes to the composition of compensation, the size of total compensation may also be impacted by the rule. In response to potential increased uncertainty, risk-averse executives may demand an offset to bear this uncertainty. Executives may also demand higher total compensation to offset the expected loss from potential recovery. This possibility was noted by a number of commenters, who suggested this increase in executive compensation would harm shareholders.[486]

We acknowledge that an increase in executive pay is a possibility. Some research suggests that as a result of recovery provisions, the total compensation of executive officers may increase, but other studies do not support this hypothesis.[487] The extent of any such increase will depend on the structure and conditions of the labor market for executive officers as well as other economic factors, including the negotiating environment and particular preferences of executives. We also note that although executives may demand and receive an increase in total

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exception under Section 162(m) of the tax code that allowed companies to deduct executives' qualified performance-based compensation in excess of $1 million reversed a related shift in executive compensation away from cash compensation and towards performance pay). In addition, the board, via the compensation committee, has oversight over executive compensation, and typically weighs a number of considerations in determining how best to incentivize performance. *See, e.g.*, Alex Edmans, *et al*., *Executive Compensation: A Survey of Theory and Evidence* (Eur. Corp. Governance Inst. (ECGI) Fin. Working Paper No. 514/2016), *available at* https://ssrn.com/abstract=2992287 (retrieved from SSRN Elsevier database) (describing the influences of boards, executives, and institutional factors such as legislation, taxation, accounting policy, compensation consultants, and proxy advisory firms on compensation outcomes).

[486] *See, e.g.,* comment letters from TCA; Ensco; Pearl Meyer; WAW; NAM; NACD; and American Vanguard.

[487] *See* DeHaan *et al*., *supra* note 62; Chen *et al*., *supra* note 462 (finding that compensation recovery provisions are associated with higher CEO compensation); and Kroos *et al*., *supra* note 479. *See also* Ramachandran Natarajan and Kenneth Zheng, *Clawback Provision of SOX, Financial Misstatements, and CEO Compensation Contracts,* 34 J. ACCT., AUDITING & FIN. 74 (2019) (finding that compared with control firms, companies with a high restatement likelihood where the CEO is the chair of the board exhibit an increase in CEO salaries between the pre- and post-Sarbanes-Oxley Act periods, suggesting that in the post-Sarbanes-Oxley Act period influential CEOs are able to receive higher salaries that are not subject to the Sarbanes-Oxley Act Section 304 clawback provision). By contrast, Erkens *et al*., *supra* note 462, finds results suggesting that while CEO incentive-based compensation may be reduced for adopters of strong compensation recovery provisions, for those companies, CEO total compensation is also reduced. The authors suggest that the findings may indicate that the adoption of strong compensation recovery provisions is associated with a broader reform package. Similarly, Iskandar-Datta *et al*., *supra* note 426, find no evidence that compensation recovery provisions entail costs in the form of higher CEO compensation following adoption nor do they influence the design of compensation contracts.

compensation relative to the baseline to offset potential losses from recovery, their new compensation agreements would reasonably be expected to tie more closely to true firm performance, as misstatement-driven determinants of pay are replaced by base pay or pay tied to accurate financial or operational metrics. This could improve alignment between executives and shareholders. In addition, improved financial reporting quality that may result from the rule and reduced likelihood of a restatement would benefit the issuer and shareholders, mitigating costs associated with any increase in executive compensation. Finally, as noted earlier in this section, shareholder engagement, other governance controls, and market forces may mitigate changes due to the final rules.

A number of commenters stated that the final rules may affect the competition among issuers to hire and retain executive officers, as well as recruitment for specific board committees.[488] Increased uncertainty that reduces the perceived value of the expected incentive-based compensation of an executive officer, or expectation of lower total compensation due to recovery, could cause listed issuers to have more difficulty attracting talented executives. As a result, listed issuers could potentially experience a comparative disadvantage relative to companies that are not covered (*i.e.*, unlisted issuers and private companies).[489]

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[488] *See, e.g.,* comment letter from Compensia (noting that no-fault recovery would have dramatic adverse effects on issuers such as individuals negotiating to avoid executive officer status). In addition, Compensia contends that the rule would put increased pressure on the boards and managers responsible for reviewing financial statements and executive compensation, making audit committee and compensation committee service less attractive. *See also* comment letters from Ensco; Kovachev; NAM; Pearl Meyer; and American Vanguard. Another commenter, however, suggests that clawback rules should not impede the ability of issuers to recruit executives. *See* comment letter from Occupy.

[489] *See, e.g.,* comment letter from IBC (noting that narrowing the market of available and interested executives in any increment is not in the shareholders' best interest). *See* also comment letter from Davis Polk 3 (noting that having compensation subject to change for matters out of their control ("no-fault") could lower executives' morale and satisfaction, causing executives to shy away from working with public companies). *See also* comment letters from NAM; and American Vanguard.

While we acknowledge this possibility, this concern is mitigated if the potential impacts to compensation discussed earlier in this section, that total executive compensation may increase or shift to forms that are not recoverable, manifest to some degree. To the extent issuers adjust total compensation for executive officers and design alternative incentive packages, we expect that the competitiveness of listed issuers in the executive labor market may remain unchanged. In addition, studies have shown that listed firms offer higher total executive compensation than unlisted firms of comparable size and other characteristics.[490] We thus believe it is unlikely executives will significantly disfavor listed firms from their choice set of employment opportunities.

One commenter suggested that "clawback risk may deter executives from undertaking or approving business strategies with more complex accounting methods, since the complexity may add to the likelihood of a reporting error and corresponding clawback of their compensation."[491] We acknowledge this concern but note research shows that adoption of voluntary recovery provisions is associated with improved managerial decision making.[492]

6. Effects of Disclosure and Tagging Requirements

Under the final rules, the listed 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. To the extent that listed issuers that currently have compensation recovery policies might not disclose the existence or the specific

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[490] *See* Huasheng Gao and Kai Li, *A Comparison of CEO Pay–Performance Sensitivity in Privately-Held and Public Firms,* J. CORP. FIN. 35 (2015) *available at* https://www.sciencedirect.com/science/article/pii/S0929119915001261 (finding that CEOs in public firms are paid 30% more than CEOs in comparable private firms).

[491] *See* comment letter from NAM.

[492] As noted above, some research shows that adoption of voluntary recovery provisions is associated with improved managerial decision making. *See supra* notes 463 and 473.

terms of that policy, there may be direct benefits of this disclosure requirement separate from any pecuniary recovery following an accounting restatement. The disclosure requirements are intended to inform shareholders and the listing exchange as to the substance of a listed issuer's recovery policy and how the listed issuer implements that policy in practice. For instance, the disclosure requirements include the date of and amount of erroneously awarded compensation attributable to the accounting restatement, certain estimates that were used in determining the amount, and the amounts that have been collected, are still owed, and are forgone. The final rules also require issuers to indicate by a check box on the cover page of their annual reports whether the financial statements of the registrant included in the filing reflect correction of an error to previously issued financial statements and whether any of those error corrections are restatements that required a recovery analysis.

The final rules also require the disclosure (including the cover page check boxes) be provided in Inline XBRL, a structured (*i.e.,* machine-readable) data language. This may facilitate the extraction and analysis (*e.g.*, comparison, aggregation, filtering) of the disclosed information across a large number of issuers or, eventually, over several years. XBRL requirements for public operating company financial statement disclosures have been observed to mitigate information asymmetry by reducing information processing costs, thereby making the disclosures easier to access and analyze.[493] While these observations are specific to operating

[493] *See, e.g.*, Jeff Zeyun Chen *et al*., *Information Processing Costs and Corporate Tax Avoidance: Evidence From the SEC's XBRL Mandate* (Jan. 11, 2021), 40 J. ACCT. & PUB. POL'Y 2 (finding XBRL reporting decreases likelihood of firm tax avoidance because "XBRL reporting reduces the cost of IRS monitoring in terms of information processing, which dampens managerial incentives to engage in tax avoidance behavior"); *see also* Paul A. Griffin *et al*., *The SEC's XBRL Mandate and Credit Risk: Evidence on a Link Between Credit Default Swap Pricing and XBRL Disclosure,* AM. ACCT. ASS'N ANN. MEETING, (2014) (finding XBRL reporting enables better outside monitoring of firms by creditors, leading to a reduction in firm default risk); *see also* Elizabeth Blankespoor, *The Impact of Information Processing Costs on Firm Disclosure Choice: Evidence from the XBRL Mandate,* 57 J. OF ACC. RES. 919, 919- 967 (2019) (finding "firms increase their quantitative footnote disclosures upon implementation of XBRL detailed tagging requirements designed to reduce information users'

company financial statement disclosures and not to disclosures outside the financial statements, such as the compensation recovery disclosures, they suggest that the Inline XBRL requirements could directly or indirectly (*i.e.*, through information intermediaries such as financial media, data aggregators, and academic researchers) provide investors with increased insight into information related to compensation recovery at specific issuers and across issuers, industries, and time periods.[494] Additionally, requiring Inline XBRL tagging of the compensation recovery disclosure benefits investors by making the disclosures more readily available and easily accessible to investors, market participants, and others for aggregation, comparison, filtering, and other analysis, as compared to requiring a non-machine readable data language such as ASCII or HTML.

The compliance costs associated with the final rules, which apply only to listed issuers, would include costs attributable to the Inline XBRL tagging requirements. Various preparation solutions have been developed and used by operating companies to fulfill XBRL requirements, and some evidence suggests that, for smaller companies, XBRL compliance costs have decreased over time.[495] The incremental compliance costs associated with Inline XBRL tagging

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processing costs," and "both regulatory and non-regulatory market participants play a role in monitoring firm disclosures," suggesting "that the processing costs of market participants can be significant enough to impact firms' disclosure decisions").

494 *See, e.g.*, Nina Trentmann, *Companies Adjust Earnings for Covid-19 Costs, But Are They Still a One-Time Expense?,* WALL ST. J. (Sept. 24, 2020, 3:54AM) (citing an XBRL research software provider as a source for the analysis described in the article), *available at* https://www.wsj.com/articles/companies-adjust-earnings-for-covid-19-costs-but-are-they-still-a-one-time-expense-11600939813 (retrieved from Factiva database); *see also* XBRL Int'l, *Bloomberg Lists BSE XBRL Data* (Mar. 17, 2019), *available at* https://www.xbrl.org/news/bloomberg-lists-bse-xbrl-data/; *see also* Rani Hoitash and Udi Hoitash, *Measuring Accounting Reporting Complexity With XBRL*, 93 ACCT. REV. 259 (2018), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2433677 (retrieved from SSRN Elsevier database).

495 An AICPA survey of 1,032 reporting companies with $75 million or less in market capitalization in 2018 found an average cost of $5,850 per year, a median cost of $2,500 per year, and a maximum cost of $51,500 per year for fully outsourced XBRL creation and filing, representing a 45% decline in average cost and a 69% decline in median cost since 2014. *See* Michael Cohn, *AICPA Sees 45% Drop in XBRL Costs for Small Companies,* ACCT. TODAY (Aug. 15, 2018), *available at* https://www.accountingtoday.com/news/aicpa-sees-45-drop-in-

requirements under the final rules are mitigated by the fact that most issuers subject to the tagging requirements are or will be subject to other Inline XBRL requirements for other disclosures in Commission filings, including financial statement and cover page disclosures in certain periodic reports and registration statements.[496] Such issuers may be able to leverage existing Inline XBRL preparation processes and expertise in complying with the Inline XBRL tagging requirements under the final rules.

With the new disclosures, investors may 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 listed issuers will be required to adopt and comply with a recovery policy satisfying the requirements of the final rules, issuers will 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-back 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 marginally improve allocative efficiency by allowing investors to make more informed investment decisions based on a better understanding of the incentives of the executive

xbrl-costs-for-small-reporting-companies (retrieved from Factiva database). In addition, a 2018 NASDAQ survey of 151 listed registrants found an average XBRL compliance cost of $20,000 per quarter, a median XBRL compliance cost of $7,500 per quarter, and a maximum XBRL compliance cost of $350,000 per quarter in XBRL costs. *See* Letter from Nasdaq, Inc. (Mar. 21, 2019) (to the Request for Comment on Earnings Releases and Quarterly Reports); *see Request for Comment on Earnings Releases and Quarterly Reports*, Release No. 33-10588 (Dec. 18, 2018) [83 FR 65601 (Dec. 21, 2018)].

[496] *See* 17 CFR 229.601(b)(101), General Instruction C.4 of Form N-CSR, and 17 CFR 232.405.

officers. The requirement to publish recovery policies may make such variation more likely to emerge.[497]

Further, if at any time during the last completed fiscal year a listed issuer's recovery policy required an issuer to recover erroneously awarded compensation, the final rules will require the issuer to disclose details of the recovery efforts under Item 402(w) of Regulation S-K. These disclosures will allow existing and prospective shareholders to observe whether issuers are enforcing their recovery policies consistent with Section 10D. This will 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 (*e.g.*, because the expense of enforcing recovery rights would exceed the amount of erroneously awarded compensation 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. As a commenter noted, there are a number of direct costs for issuers resulting from the disclosure requirements of the final rules.[498] First, issuers will incur direct costs to file their compensation recovery policies as an exhibit to their Exchange Act annual reports. For purposes of our Paperwork Reduction Act Analysis, we estimate that the exhibit filing requirement would impose a minimal burden of 0.4 hours per issuer. Second, if an issuer is required to recover erroneously awarded compensation, or if there is an outstanding balance from application of the recovery policy to a prior restatement, the issuer would incur a direct cost to prepare and disclose

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[497] 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 final rules may make the signal more credible and allow issuers to differentiate themselves based on variation in the scope of a recovery policy.

[498] *See, e.g.,* comment letter from IBC (noting that the "necessity for additional disclosures as well as the XBRL requirement increase the administrative cost to the registrant due to the substantial increase in the amount of information required for disclosure and the complexity of formatting data in XBRL")

the information required by Item 402(w) of Regulation S-K, Item 6.F of Form 20-F, or paragraph B.19 of Form 40-F, as applicable (or, for registered management investment companies, Item 18 to Form N-CSR and Item 22(b)(20) of Schedule 14A) and the corresponding narrative. For purposes of our PRA, we estimate that the final disclosure requirement, including costs to tag the required disclosure in Inline XBRL, as described above, would impose a burden of 25 hours per issuer.[499]

7. Indemnification and Insurance

Many of the benefits discussed above would result from an executive officer's changes in behavior as a result of incentive-based compensation being at risk for recovery should a "Big R" or "little r" restatement be required. These benefits would be substantially undermined if the issuer were able to indemnify the executive officer for the loss of compensation.[500] Moreover, as a commenter noted, shareholders would bear the cost of providing such indemnification.[501] Therefore, the indemnification provision prohibits listed issuers from indemnifying current and former executive officers against the loss of erroneously awarded compensation or paying or reimbursing such executives for insurance premiums to cover losses incurred under the recovery policy.[502]

Although reimbursement of insurance premiums by issuers would be prohibited, the insurance market may develop an insurance product that would allow an executive officer, as an

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499 *See* Section V.C., for a more extensive discussion of these disclosure burdens, including the monetization and aggregation across issuers of these direct costs.

500 Several commenters offered suggestions on this issue, *see* Section II.E.2.

501 *See, e.g.,* comment letter from Rosanne D. Balfour, discussing this potential outcome.

502 As an example of the type of indemnification that is prohibited, one commenter noted that when Wilmington Trust was required to recover $2 million from an executive under the TARP clawback rules, the company responded by increasing the executive's base salary by 25%. *See* comment letter from Kovachev. *See also* the discussion *infra* at note 368.

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 officer would be able to hedge some of the risk that results from a recovery policy. If an executive officer 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 officer'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 officer, then incentives would remain for the executive to avoid inappropriate actions.

The development of this type of private insurance policy for executive officers would also have implications for issuers. Overall, it could make it less costly for an issuer to compensate an executive officer after implementing a recovery policy. If an active insurance market develops such that the executive officer 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 indemnification provision prohibits issuers from reimbursing a current or former executive officer 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 officer's compensation. This increase may be less than the increase in the market-determined compensation packages if an insurance policy was unavailable because an insurance company may be more willing to bear uncertainty than a risk-averse executive.

8. Effects May Vary for Different Types of Issuers

The effects of the final rules 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 have different compensation structures, financial reporting complexity, or quality than other issuers. Analysis by Commission staff indicates that SRCs, on average, use a lower proportion of incentive-based compensation than non-SRCs, suggesting a lower potential impact of the final rules on SRCs.[503] On the other hand, as discussed in Section IV.A., only 34% of SRCs currently have a recovery policy in place in contrast to 71% of larger domestic issuers. As a result, SRCs may experience more dramatic benefits as well as larger costs, relative to the baseline. 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 restatements and recoveries at SRCs.[504] Academic studies suggest that the likelihood of reporting a material weakness in internal control over financial reporting decreases as the size of the issuer increases.[505] This may imply that, relative to non-SRCs, the final rules may cause executive officers at SRCs to devote proportionately more resources to the production of high-quality financial reporting. Finally, to the extent that implementation of the final rules entails

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503 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 2021. Staff found that, on average, SRCs pay 47% of total compensation in base salary versus 20% for non-SRCs; SRCs pay 19% of total compensation in stock awards versus 45% for non-SRCs; SRCs pay 7% of total compensation in non-equity incentive plan compensation versus 18% for non-SRCs; SRCs pay 6% of total compensation as a bonus versus 2% for non-SRCs; and SRCs pay 16% of total compensation in option awards versus 8% 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 rule, these differences should be taken as maximum estimated differences of incentive-based compensation for named executive officers. Staff did not find significant differences between SRCs and non-SRCs in the percent of compensation paid in nonqualified deferred compensation, or in other compensation. We also note that the final rule covers a broader set of employees than the named executive officers required to report within the Summary Compensation Table.

504 *See* Susan Scholz, *Financial Restatement: Trends in the United States 2003-2012,* Ctr. Audit Quality, Washington, DC, (2013).

505 *See, e.g.,* Jeffrey T. Doyle *et al*., *Determinants of Weaknesses in Internal Control Over Financial Reporting,* 44 J. ACCT. & ECON. 193 (2007) *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=770465 (retrieved from SSRN Elsevier database).

fixed costs, SRCs, because of their smaller size, would incur a greater proportional compliance burden than larger issuers.

The final rules 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.[506] 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 above, 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, including both "Big R" and "little r" restatements. This reduced incentive could have a greater impact for EGCs, relative to non-EGCs, to the extent that executive officers at EGCs are more likely to forgo value-enhancing growth opportunities as a result of the final rules, 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,[507] which may imply that EGCs have a higher likelihood of an accounting restatement and a higher likelihood of reporting a material weakness in internal control over financial reporting. Similar to SRCs, this may imply that, relative to non-EGCs, the final rules may cause executive officers at EGCs to devote

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[506] In an analysis of 446 EGCs with fiscal year 2021 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. 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 above that level; and staff restricted the analysis to companies that issued common equity and were listed on NYSE, NYSE MKT, or NASDAQ.

[507] Using the same dataset referenced in note 322, staff found the average market capitalization of EGCs is approximately $1.5 billion while the average market capitalization of non-EGCs is approximately $14.6 billion. Staff also found the smallest EGCs tend to be relatively close 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 $40.6 million and $60.5 million, respectively. Conversely, staff found 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 $2.9 billion and $21.9 billion.

proportionately more resources to the production of high-quality financial reporting. Also, as discussed in Section IV.A., only 19% of EGCs currently have a recovery policy in place compared to 71% of larger domestic issuers . As a result, EGCs may experience more dramatic changes relative to the baseline.

Some commenters have noted that SRCs and EGCs may face disproportionate costs.[508] One commenter noted that these companies may benefit disproportionately,[509] and another commenter indicated that the benefits may be lower for companies immediately following the IPO process.[510] We acknowledge that SRCs and EGCs may face disproportionate costs of compliance as compared to other companies, but also note that our baseline analysis suggests that fewer of these companies may have implemented compensation recovery policies[511] and consequently may realize disproportionate benefits.[512]

In addition, we recognize that there may be additional specific costs and benefits for FPIs. While we believe the typical issuer is unlikely to transfer listing in the short-term as a result of the final rules, the potential response of FPIs is less clear. On one hand, by virtue of listing on a U.S. exchange, an FPI has demonstrated willingness to list outside of the issuer's

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[508] *See, e.g.,* comment letter from ABA 1 (indicating that SRCs and EGCs are likely to bear significant costs in enforcing a mandatory compensation recovery policy and that the proposed rule would create a costly incentive for newly public issuers to avoid the use of incentive based compensation); CCMC 2 (indicating that the costs would be disproportionate); Compensia (indicating that SRCs and EGCs would face disproportionate costs); Mercer (indicating that the rule could impede the facilitation of capital formation for SRCs and EGCs); and NACD (suggesting the rule "puts an inordinate burden on smaller companies, which cannot always afford the kind of compliance costs entailed by new rules").

[509] *See, e.g.,* comment letter from Public Citizen 1 (suggesting that "the chance for manipulation [at SRCs] is perhaps even greater at such companies than at larger firms with a wider and arguably more vigilant shareholder base").

[510] *See, e.g.,* comment letter from Compensia (suggesting that for EGCs, "the likelihood of a financial restatement in the period immediately following an IPO would be minimal given the degree of scrutiny the issuer must undergo during the offering process").

[511] *See* Section IV.A.

[512] *See supra* note 413.

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.

Commenters have noted that the final rules would increase the compliance burden on FPIs and could thereby potentially reduce the advantage of listing on a U.S. market.[513] One commenter noted that the final rules would cause a competitive disadvantage for domestic issuers as compared to foreign issuers,[514] and others noted that they may encourage foreign governments to pass laws that disadvantage or penalize U.S. corporations.[515] In addition, commenters noted that U.S. corporations operating in jurisdictions outside the United States would face similar compliance hurdles as FPIs.[516]

We recognize that FPIs may bear additional compliance costs, as noted by commenters, relative to non-FPI listed issuers. As a result, FPIs could choose to delist from U.S. exchanges.[517] Further, FPIs that are not currently listed on U.S. exchanges, but are considering listing on a non-home country exchange, may choose to list on another non-home foreign

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513 *See, e.g.,* comment letters from CCMC 1; and Coalition. *See also, e.g.,* comment letter from Freshfields (noting that the rules will require FPIs to identify and keep track of executive officers consistent with Section 16, and stating that, as a result of such requirements, the Economic Analysis in the Proposing Release understates the compliance burden for FPIs, especially if the FPI becomes subject to two clawback regimes); and Kaye Scholer (stating that the proposal does not give due consideration to or address the complications that would arise where an FPI is also required to recover compensation under home country rules, such as situations where the home country has a different definition of incentive-based compensation). In addition, *see* comment letter from UBS (noting that it may lose attractiveness as an employer as a result of the proposed rules).

514 *See* comment letter from Bishop.

515 *See* comment letters from CCMC 1; and Coalition.

516 *See, e.g.,* comment letters from CCMC 1; and Coalition.

517 *See supra* note 261, describing feedback from commenters who note that the rules may create potential disincentives for FPIs to list on U.S. exchanges. *See also* comment letter from Davis Polk 1 (noting that "adoption of Section 404 of the Sarbanes-Oxley Act of 2002 led 51.6% of foreign firms to consider delisting from U.S. exchanges, and led 76.8% of small foreign firms to consider delisting, with 98 foreign firms de-listing in 2002," citing SEC Office of Economic Analysis, *Study of the Sarbanes-Oxley Act of 2002 Section 404 Internal Control over Financial Reporting Requirements* (Sep. 2009), *available at* https://www.sec.gov/news/studies/2009/sox-404_study.pdf.)

exchange because of the increased burden of our final rules. At the same time, we understand that one of the benefits of listing on a U.S. exchange is that an issuer can signal the high quality of its corporate governance, which is achieved by subjecting itself to the rigorous corporate governance rules and regulations of a U.S. exchange.[518] By listing on U.S. exchanges, many FPIs may gain the ability to raise capital at a reduced cost compared to their home market. Hence, some FPIs seeking access to U.S. capital markets may view the requirements as beneficial.

We also recognize that the final rule may have different effects on listed funds. One commenter noted that listed funds' financial statements are less complex than operating company financial statements and that accounting restatements are relatively rare for funds.[519] The commenter also stated that the proposal could affect more than the small number of internally managed listed funds that the Commission estimated in the proposal, because some externally managed listed funds may pay some or all of the funds' chief compliance officers' compensation.

We recognize that there is a wide range of complexity in issuer financial reporting. Issuers with less complex financial reporting, such as some listed funds, may realize fewer benefits from the final rule. We also anticipate that such issuers may experience fewer costs, as fewer compensation contracts may be affected, and potential trigger events would be relatively rare. In addition, we recognize that listed funds that pay for their chief compliance officers'

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[518] *See, e.g.,* Craig Doidge *et al.*, *Why do Foreign Firms Leave U.S. Equity Markets?,* 65 J. FIN., 1507 (2010), (noting that by subjecting themselves to U.S. laws and institutions, insiders of foreign firms credibly bond themselves to avoid some types of actions that might decrease the wealth of minority shareholders.) *But see* comment letter from Kaye Scholer (arguing that U.S. standards for corporate governance may not be more rigorous than other jurisdictions, and further that it is not clear that FPIs list on a U.S. exchange to signal their high quality corporate governance rather than to access U.S. capital markets or to provide more liquidity for their stock).

[519] *See* comment letter from ICI.

compensation would be affected by the final rule, and that as a result, the number of affected funds likely exceeds the estimate provided in the Proposing Release.

C. Alternatives

Below we discuss possible alternatives to the final rules 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 final rules may impose certain disproportionate costs on SRCs and EGCs. However, smaller issuers, SRCs and EGCs, may have an increased likelihood of reporting an accounting error and may be more likely to report a material weakness in internal control over financial reporting.[520] As more fully discussed in Section II.A.3, while the Commission has the authority to exercise its discretion to exempt such issuers, Congress did not direct the Commission to consider differential treatment for recovery of incentive-based compensation that was not earned and should not have been paid for SRCs or EGCs. As such, we see no reason why shareholders of smaller issuers should not benefit from recovery of erroneously awarded compensation in the same manner as shareholders of larger issuers.

A number of commenters suggested that we consider exempting FPIs, arguing that home countries would generally have a greater interest in determining whether issuers should have recourse against executive officers.[521] Another commenter suggested that some issuers may be required to implement two different recovery policies, and also noted that FPIs are not currently

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[520] *See,* Choudhary *et al*., *supra* note 61 (finding that future restatements are less likely for larger firms). *See also* comment letter from Public Citizen 1 (arguing that the risk of manipulation is greater at smaller companies).

[521] *See, e.g.,* comment letters from the ABA 1; Bishop; and Davis Polk 1.

required to identify Section 16 officers. As a result, the commenter stated that the economic analysis in the Proposing Release understated the costs for FPIs.[522]

As discussed previously in the context of FPIs generally, the potential effect of the final rules on FPIs is difficult to predict. On the one hand, due to the potential differences in home country law, the final rule requirements may be especially burdensome for FPIs relative to non-FPIs.[523] On the other hand, there is evidence that many FPIs may be listing on U.S. exchanges in part to credibly signal to investors their willingness and ability to be subjected to stricter governance standards.[524] While FPIs may face a relatively higher burden from the final rules, they also may experience a relatively higher benefit. As more fully discussed in Section II.A.3, while the Commission has the authority to exercise its discretion to exempt such issuers, the concerns expressed by commenters do not in our view justify exempting all FPIs from the obligation to recover incentive-based compensation that was erroneously awarded. Moreover, the recovery requirements will help to encourage reliable financial reporting by listed issuers, which is as important for investors in FPIs as for other issuers. Studies have shown that foreign companies present a similar risk of restatement as other companies[525] and that U.S. issuers who are non-accelerated filers accounted for approximately 53% of restatements.[526] To the extent that recovery under Rule 10D-1 would be wholly inconsistent with a foreign regulatory regime,

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522 *See supra* footnotes 32 through 37; *see also* comment letter from Freshfields ("we expect all UK companies that are FPIs either already have a clawback in place, or will implement one when their directors' remuneration policy is next submitted for shareholder approval," and "we believe that the Economic Analysis in the Release understates the compliance burden for FPIs especially if the FPI becomes subject to two clawback regimes").

523 We note that if recovery of erroneously awarded compensation would violate home country laws that were in effect as of the date of publication of Rule 10D-1 in the Federal Register, the final rules may permit the board of directors discretion to forgo recovery as impracticable, subject to certain conditions.

524 *See* Craig Doidge *et al*., *supra* note 518.

525 *See supra* note 56.

526 *See* A Twenty-Year Review.

we have included an impracticability accommodation, as discussed in Section II.C.3.b., which may alleviate some of the implementation challenges faced by FPIs.

Certain commenters also suggested we unconditionally exempt listed funds, rather than the conditional exemption we are adopting. Listed funds, unlike most other issuers, are generally externally managed and often have few, if any, employees that are compensated by the fund (*i.e.*, the issuer). As discussed above, the final rules are designed to reflect the structure and compensation practices of listed funds by requiring funds to implement compensation recovery policies only when they in fact award incentive-based compensation covered by Section 10D. As such, we believe the rules are appropriately tailored as applied to funds in that they will only apply to the small subset of listed funds that award incentive-based compensation covered by Section 10D.

2. Excluding Incentive-Based Compensation Tied to Stock Price

The final rule encompasses incentive-based compensation tied to measures such as stock price and TSR because improper accounting affects such financial reporting measures and in turn results in excess compensation. As discussed above, the final rules may result in 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 final rules, 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 final rules 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.[527] To this end, accounting-based measures of performance – although not directly tied to issuer value enhancement – may better capture the effect of an executive officer's actions during the relevant performance period. Therefore, if incentive-based compensation tied to stock price were 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 officer's actions during the performance period. Since changes in compensation practices away from the current market practices may be either beneficial to issuers or not, depending on whether current practices are optimal, it is unclear that shifting compensation toward forms tied to market-based metrics would be beneficial.

The optimal compensation package may contain a mix of incentive-based compensation

[527] All of the seven most frequently used metrics to award compensation in short-term incentive plans were accounting-based measures. Those measures are operating income, revenue, cash flow, EPS, return measures, operating income margin, and net income. *See* Meridian Report. *See also supra* note 356.

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.[528] Using market-based measures of performance in short-term incentive plans may be undesirable for the executive officer 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 officer'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 officer'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 consequently may adversely affect the incentives of the executive officer.

3. Including only "Big R" restatements as trigger events

The Commission considered adopting final rules that would provide that recovery is required with respect to only "Big R" restatements that correct errors that are material to previously issued financial statements. Under that alternative, "little r" restatements would not trigger a potential recovery.

As discussed above, some commenters have provided feedback indicating that there are substantial benefits associated with including "little r" restatements as trigger events, including

[528] *See* Meridian Report.

the likelihood that the final rules will provide stronger incentives for managers to monitor the accuracy of financial statements.[529] Were we to include only "Big R" restatements, those benefits would not be realized. However, other commenters have noted that the inclusion of "little r" restatements as trigger events may increase the costs of compliance with the final rules compared to an alternative of including only "Big R" restatements.[530] Although it is possible that certain compliance costs may be higher as a result of the inclusion of "little r" restatements in the scope of potential trigger events, as discussed above, not every restatement would trigger a recovery of compensation that was earned as a result of meeting performance measures.[531] In addition, issuers are already required to perform a materiality analysis on each error that is identified in order to determine how to account for and report the correction of that error, and in that context, issuers may have already calculated the impact of the error on executive compensation. Furthermore, the broader scope of encompassing "little r" restatements addresses concerns that issuers could manipulate materiality and restatement determinations to avoid application of the compensation recovery policy.[532]

4. Other Alternatives Considered

Some commenters suggested that issuers may choose to implement a nonqualified deferred compensation plan (*e.g.*, a "holdback plan") to aid in the recovery of erroneously

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529 *See supra* note 84.

530 *See supra* note 88. Also, as noted in the Second Reopening Release, the inclusion of "little r" restatements as potential trigger events increases the number of potential trigger events.

531 We expect that recovery of incentive-based compensation that is tied to TSR would be relatively small and infrequent as a result of "little r" restatements, since these restatements are less likely to be associated with significant stock price reactions. *See* Choudhary *et al.*, *supra* note 61 (finding an average stock price reaction of -3.3% to "Big R" restatements and -0.3% for "little r" restatements); Thompson, *supra* note 79 (finding an average stock price reaction of -1.5% to "Big R" restatements and -0.3% for "little r" restatements).

532 *See supra* note 107.

awarded incentive-based compensation.[533] One commenter suggested that the Commission specifically require the use of a holdback plan,[534] and another commenter noted that such a plan may raise significant tax issues and recommended that the Commission provide the board of directors with broad discretion.[535] A holdback plan would likely reduce the costs of recovering erroneously awarded incentive-based compensation. On the other hand, a holdback plan may further augment any increase in compensation necessary to offset the expected cost to the executive officer of a recovery policy. This is due to the executive officer not having access to the funds she has earned and having to delay consumption that would otherwise be possible. These considerations suggest that a holdback plan could be efficient at some issuers but inefficient at others. We note that the rule does not mandate a holdback plan, but also does not prevent issuers from adopting a holdback plan if they so choose.

One commenter suggested that the Commission consider also requiring recovery of proportional incentive compensation, whether or not it is numerically connected to the restated financial results. This suggestion would require issuers, in the event of a restatement, to recover a proportionate amount of the compensation tied to qualitative variables or board judgment.[536] Relative to the final amendments, this alternative implementation would reduce the incentive to alter the composition of an executive officer'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

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533 *See* comment letter from Compensia; NACD; and Bhagat and Elson. *See also* Stuart Gillan and Nga Nguyen, *Clawbacks, Holdbacks, and CEO Contracting,* 30 J. APPL. CORP. FIN., 53 (2018).

534 *See* comment letter from Bhagat and Elson.

535 *See* comment letter from ABA 1.

536 *See* comment letter from Public Citizen 1.

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, as suggested by the commenter, we agree that 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 could also increase the amount of expected compensation the executive officer would require in order to voluntarily bear the increased uncertainty.

V. PAPERWORK REDUCTION ACT

A. Summary of the Collection of Information

Certain provisions of our rules, schedules, and forms that will be affected by the final rules contain "collection of information" requirements within the meaning of the Paperwork Reduction Act. The Commission published a notice requesting comment on changes to these collections of information in the Proposing Release and submitted these requirements to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[537] While a number of commenters provided comments on the potential costs of the proposed rules, as well as factors that could affect the scope of entities covered by the proposal, commenters did not specifically address our PRA analysis.[538]

The hours and costs associated with preparing, filing, and distributing the schedules and forms constitute reporting and cost burdens imposed by each collection of information. An

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[537] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

[538] *See supra* Section II. One commenter contended that the Reopening Release should have included an updated PRA analysis. *See* comment letter from Toomey/Shelby, *supra* note 14.

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. Compliance with the information collections is mandatory. Responses to the information collections are not confidential and there is no mandatory retention period for the information disclosed. The titles for the affected collections of information are:

"Form 10-K" (OMB Control No. 3235-0063);

"Form 20-F" (OMB Control No. 3235-0288);

"Form 40-F" (OMB Control No. 3235-0381); and

"Form N-CSR", Certified Shareholder Report of Registered Management Investment Companies" (OMB Control No. 3235-0570).[539]

The Commission adopted Form 10-K, Form 20-F and Form 40-F under the Exchange Act. Form N-CSR was adopted under the Exchange Act and Investment Company Act. The forms set forth the disclosure requirements to help shareholders make informed voting and investment decisions.

B. Summary of the Final Amendments and Effect of the Final Amendments on Existing Collections of Information

To implement the provisions of Section 954 of the Dodd-Frank Act, which added Section 10D to the Exchange Act we are adopting Rule 10D-1 under the Exchange Act as well as

[539] The amendments also affect the following collections of information: "Regulation 14A and Schedule 14A" (OMB Control No. 3235-0059); "Regulation 14C and Schedule 14C" (OMB Control No. 3235-0057); and "Rule 20a-1 under the Investment Company Act of 1940, Solicitations of Proxies, Consents, and Authorizations" (OMB Control No. 3235-0158). Regulations 14A and 14C and the related schedules require the new disclosure to be included in proxy and consent solicitations. Rule 20a-1 requires funds to comply with Regulation 14A, Schedule 14A, and all other rules and regulations adopted pursuant to Section 14(a) of the Exchange Act that would be applicable to a proxy solicitation if it were made in respect of a security registered pursuant to Section 12 of the Exchange Act. As noted below, for purposes of the PRA and in order to avoid the PRA inventory reflecting duplicative burdens, we assume the disclosure will be incorporated by reference into Form 10-K and Form N-CSR from proxy and information statements and do not include a separate burden for these collections of information. *See* notes 543 and 544.

amendments to Items 402, 404, and 601 of Regulation S-K; Rule 405 of Regulation S-T; Schedule 14A; Form 20-F; Form 40-F; Form 10-K; and Form N-CSR. Rule 10D-1 directs national securities exchanges and associations to establish listing standards that require listed issuers to adopt and comply with written policies for recovery of erroneously awarded 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. As described in more detail above, we are also adopting new disclosure requirements in Schedule 14A, Form 10-K, Form 20-F, Form 40-F, and Form N-CSR to require issuers listed on an exchange to file their written compensation recovery policy as an exhibit to their annual reports. Form 10-K, Form 20-F, Form 40-F additionally require issuers listed on an exchange to indicate by a check box on the cover page of their annual reports whether the financial statements of the registrant included in the filing reflect correction of an error to previously issued financial statements and whether any of those error corrections are restatements that required a recovery analysis; and disclose actions an issuer has taken pursuant to such recovery policy. These disclosures will also be required to be provided in tagged data language using Inline XBRL.[540]

The additional information a listed U.S. issuer is required to compile and disclose regarding its policy on incentive-based compensation pursuant to Item 402(w) supplements information that U.S. issuers often provide elsewhere in their executive compensation disclosure.[541] Similarly, for a listed FPI filing an annual report on Form 20-F or, if a FPI elects to

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[540] While paperwork burdens associated with investment company interactive data requirements are generally accounted for in the Information Collection titled "Registered Investment Company Interactive Data," any burdens associated with interactive data for investment companies associated with the final rules are estimated to be negligible. For administrative simplicity, these burdens therefore are incorporated into the burdens associated with the Form N-CSR Information Collection, discussed below.

[541] These issuers are required to provide information relating to the compensation of their named executive officers that may include policies and decisions regarding the adjustment or recovery of awards or payments if the

use domestic registration and reporting forms, on Form 10-K, the amendments supplement existing disclosures.[542] We anticipate that new disclosure and submission requirements will increase the amount of information that listed U.S. issuers and listed FPIs must compile and disclose and therefore increase the burdens and costs for the affected registrants.

For listed U.S. issuers, other than registered management investment companies, the amendments require additional Item 402 disclosure in certain required reports and will increase the burden hour and cost estimates associated with Form 10-K.[543] For listed registered management investment companies, the amendments to Form N-CSR and Schedule 14A require additional disclosure and will increase the associated burden hour and cost estimates, if the registered investment company pays incentive-based compensation, for Form N-CSR.[544] For listed FPIs filing an annual report on Form 20-F, Form 40-F or, if a FPI elects to use U.S.

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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. *See* 17 CFR 229.402(b)(2)(viii). SRCs and EGCs generally are subject to scaled executive compensation disclosure requirements in Item 402 of Regulation S-K. *See* 17 CFR 229.402(*l*) and Section 102(c) of the JOBS Act. However, the requirements of new Item 402(w) are not scaled and thus SRCs and EGCs will be required to provide all of the disclosures called for by this item. Accordingly, we have not calculated separate or different paperwork burdens with respect to Item 402(w) for these classes of issuers. With respect to registered management investment companies, under the final rules, information mirroring Item 402(w) disclosure must be included in annual reports on Form N-CSR and in proxy statements and information statements relating to the election of directors.

542 *See* Item 6.B and Item 7.B. of Form 20-F.

543 For purposes of our PRA estimates, consistent with past amendments to Item 402, we assume that all of the burden relating to the new narrative disclosure requirements in Schedule 14A and Schedule 14C 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. We are therefore not allocating a separate burden estimates for Regulation 14A/Schedule 14A and Regulation 14C/Schedule 14C. 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 (Aug. 29, 2006) [71 FR 53158].

544 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 will be associated with Form N-CSR, and therefore, we are not allocating a separate burden estimate for Schedule 14A or Rule 20a-1 under the Investment Company Act with respect to disclosure by such funds.

registration and reporting forms, on Form 10-K, the amendments require additional disclosure in annual reports and will increase the burden hour and costs estimates for each of these forms.

C. Burden and Cost Estimates Related to the Final Amendments

The following table summarizes the estimated paperwork burdens associated with the amendments to the affected forms filed by listed issuers.

PRA Table 1: Estimated Paperwork Burden of Final Amendments

	Estimated Burden Increase	Brief Explanation of Estimated Burden Increase
Amendments to Reg. S-K Items 402, 404, and 601, Reg. S-T Item 405, Form 20-F, Form 40-F, Schedule 14A, Form 10-K, and Rule 10D-1, (1) Require the filing of an issuer's recovery policy as an exhibit to its Exchange Act annual report. (2) Require: o Disclosure regarding the issuer's conclusion that recovery was not required under the recovery policy or disclosure regarding how the issuer applied its recovery policy after the issuer was required to prepare an accounting restatement that required recovery under the policy, or there was an outstanding balance to be recovered; o Disclosure of the effects of the recovery on the Summary Compensation Table; o New check boxes to indicate on the cover page of issuers' annual reports whether the financial statements included in the filing reflect correction of an error to previously issued financial statements and whether such	(1) An increase of 0.4 burden hours for Form 10-K, Form 20-F, and Form 40-F. (2) An increase of 25 burden hours for each of the affected forms: Form 10-K, Form 20-F, and Form 40-F.	These increases are the estimated effect on the affected forms by the amendments to implement Section 10D, including the filing of the recovery policy, recovery policy and policy implementation disclosures, and the use of structured data for this information.

corrections are restatements that required a recovery analysis; and o The above information to be tagged using Inline XBRL.		
Amendments to Form N-CSR, and Rule 10D-1 (1) Require the filing of a fund's recovery policy as an exhibit to its Form N-CSR annual report. (2) Require: o Disclosure regarding the fund's conclusion that recovery was not required under the recovery policy or disclosure regarding how the fund applied its recovery policy after the fund was required to prepare an accounting restatement that required recovery under the policy, or there was an outstanding balance to be recovered; and o The above information to be tagged using Inline XBRL.	(1) An increase of 0.4 burden hours for the affected form: Form N-CSR (2) An increase of 25 burden hours for the affected form: Form N-CSR	These increases are the estimated effect on the affected form by the amendments to implement Section 10D, including the filing of the recovery policy, recovery policy and policy implementation disclosures, and the use of structured data for this information.

In the Proposing Release, we derived our burden hour and cost estimates by reviewing our burden estimates for similar disclosure and considering our experience with other tagged data initiatives. In particular, we noted that the preparation of the information required by Item 402(w) and the corresponding narrative disclosure provisions would be comparable to an issuer's preparation of the disclosure required by the Commission's 2009 amendments to enhance certain aspects of proxy disclosure, which were also largely designed to enhance existing disclosure requirements.[545] In addition, we believe that certain of the information required to prepare the

[545] *See Proxy Disclosure Enhancements* Release No. 33-9089 (Dec. 16, 2009) [74 FR 68334 (Dec. 23, 2009)] ("Proxy Disclosure Enhancements"), which adopted amendments to make new or revised disclosures about:

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 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.

In the Proposing Release, the Commission estimated that the average incremental burden for an issuer to prepare the new narrative disclosure would be 21 hours. The proposed estimate included the time and cost of preparing disclosure, as well as tagging the data in XBRL format. We continue to believe that these are the primary cost elements for issuers preparing the disclosure and that the elements account for 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, disclosing information regarding the application and implementation of this recovery policy if required by a restatement.

While the cost elements remain the same, we recognize that there may be some additional burden in tagging the information using Inline XBRL, using the check boxes, and providing the expanded disclosure regarding the application of the recovery policy, including disclosure analyzing how the amount of erroneously awarded compensation was calculated and explaining why an issuer concluded that a recovery of compensation was not required. As a result, we are increasing our estimate of the average incremental burden for an issuer to prepare the disclosure from 21 hours to 25 hours. We note that this estimate should represent an upward bound, as the

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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.

incremental additional disclosure associated with "little r" restatements should be lower than for "Big R" restatements because we anticipate that it will be less likely that a "little r" restatement will result in erroneously awarded compensation, and where no recovery is required the rules require less disclosure. As we noted in Section IV, we estimate that "little r" restatements may account for roughly three times as many restatements as "Big R" restatements.[546]

In addition, consistent with the Proposing Release, we separately estimate the burden of filing a listed issuer's or listed registered investment company's recovery policy as an exhibit to its annual report. In a modification from the proposal, we are reducing the estimate of the burden from approximately one hour to 0.4 hours. We estimate that the initial burden of filing the recovery policy as an exhibit will be one hour, but the ongoing burden for filing in subsequent years will be minimal, which we estimate as a burden of 0.1 hours. In order to form our estimate, we averaged the initial one hour burden with the 0.1 hour burden in subsequent years to determine the average burden over three years of 0.4 hours.

Because these estimates are 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 the overall effect of the restatement on the issuer's incentive-based compensation. Issuers subject to Item 402(w) will provide the required disclosures by either including the information directly in their Exchange Act annual reports or incorporating the information by reference from a proxy statement on Schedule 14A or information statement on Schedule 14C.

The amendments described in Section II will increase the paperwork burden for filings on the affected forms that include recovery policy exhibit filings and recovery policy disclosure.

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[546] *See* note 396 and accompanying text.

However, not all filings on the affected forms include these disclosures, either because they are not listed issuers or they are not required to provide the disclosure because they have not had to seek recovery pursuant to their recovery policy. Therefore, to estimate the increase in overall paperwork burden from the amendments, we first estimate the number of listed issuers and then estimate the number of issuers that may be required to include the recovery disclosure. Based on the staff's findings, the table below sets forth our estimates of the number of filings on these forms[547] and the number of such filings that will be required to include the recovery disclosure.[548]

PRA Table 2: Estimated Number of Affected Filings

Form	Current Annual Responses in OMB Inventory	Number of Estimated Recovery Policy Exhibit Filings	Number of Estimated Filings that Include Recovery Disclosure
10-K	8,292	4,513	226
20-F	729	722	36

[547] Of the 2,710 listed issuers that file Form N-CSR, 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, and thus may be required to file a recovery policy exhibit. 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 new Item 18 of Form N-CSR. One commenter suggested that a greater number of investment companies could be affected by the proposal, but as this commenter did not include data addressing the compensation arrangements that would fall within the scope of the proposed requirements, and because we have no other reason to believe that our estimates should be adjusted, we are not adjusting our methods of estimating the number of investment companies that the final rules would affect. *See* comment letter from ICI.

[548] *See* Section IV. In Section IV.A, we note that the report, A Twenty-One Year Review, indicated that 4.9% of issuers disclosed a restatement in 2020. In developing our estimates, we used the current annual responses in the OMB inventory for the forms as a starting point when determining the number of affected issuers. Issuers are generally only required to file one annual report on Form 10-K, Form 20-F, Form 40-F, or Form N-CSR per year. We expect, as noted above, that for purposes of the PRA, to the extent issuers provide the required information in other filings, the information will be incorporated by reference. *See* notes 543 and 544. Further, while issuers are generally required to file one annual report, the rules do not apply to all issuers, rather they only apply to listed issuers. As PRA Table 2 reflects, we estimate, based on Audit Analytics restatement data for 2021, that approximately five% of listed issuers restated their financial statements in 2020 and 2021. While recognizing that not all issuers that file restatements will be required to provide recovery disclosure, for purposes of the PRA, we use the five% figure as an upward bound, and estimate that all such issuers will provide the required disclosure.

40-F	132	132	7
N-CSR	6,898	7	1

We calculated the burden estimates by adding the estimated additional burden to the existing estimated responses and multiplying the estimated number of responses by the estimated average amount of time it would take an issuer to prepare and review disclosure required under the final amendments. For purposes of the PRA, the burden is to be allocated between internal burden hours and outside professional cost. PRA Table 3 sets forth the percentage estimates we typically use for the burden allocation for each collection of information and the estimated burden allocation for the proposed new collection of information. We also estimate that the average cost of retaining outside professionals is $600 per hour.[549]

PRA Table 3. Estimated Burden Allocation for the Affected Collections of Information

Collection of Information	Internal	Outside Professionals
Forms 10-K, N-CSR	75%	25%
Form 20-F, 40-F	25%	75%

PRA Table 4 illustrates the incremental change to the total annual compliance burden of affected forms, in hours and in costs, as a result of the amendments' estimated effect on the paperwork burden per response.[550] We note that the table includes one line for the exhibit filing requirements and a separate line for the recovery disclosure requirement, to account for the

[549] We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional services, but for purposes of this PRA analysis, we estimate that such costs would be an average of $600 per hour. At the proposing stage, we used an estimated cost of $400 per hour. We are increasing this cost estimate to $600 per hour to adjust the estimate for inflation from August 2006 to the present. The inflation-adjusted amount is $583.88, which we have rounded up to $600.

[550] These estimates represent the average burden for all issuers, both large and small. In deriving our estimates, we recognize that the burdens will likely vary among individual issuers based on a number of factors, including the size and complexity of their organizations. The OMB PRA filing inventories represent a three-year average. Some issuers may 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. Averages also may not align with the actual number of filings in any given year.

differences in the number of estimated responses.

PRA Table 4. Calculation of the Incremental Change in Burden Estimates of Current Responses Resulting from the Final Amendments

Collection of Information	Number of Estimated Affected Responses (A)[a]	Burden Hour Increase per Response (B)	Change in Burden Hours (C) = (A) x (B)	Change in Company Hours (D) = (C) x 0.75 or 0.25	Change in Professional Hours (E) = (C) x 0.25 or 0.75	Change in Professional Costs (F) = (E) x $600
10-K Exhibit	4,513	0.4	1,805	1,354	451	$270,600
10-K	226	25	5,650	4,238	1,412	$847,200
20-F Exhibit	722	0.4	289	72	217	$130,200
20-F	36	25	900	225	675	$405,000
40-F Exhibit	132	0.4	52.8	13	40	$24,000
40-F	7	25	175	44	131	$78,600
N-CSR Exhibit	7	0.4	3	2	1	$600
N-CSR	1	25	25	19	6	$3,600

PRA Table 5 illustrates the incremental change to the total annual compliance burden of affected forms, in costs, as a result of the adjustment to the average cost of retaining outside professionals from $400 to $600 per hour.[551]

PRA Table 5. Calculation of the Incremental Change in Costs of Current Responses Resulting from the Average Cost Adjustment

Collection of Information	Number of Affected Responses	Current Cost Burden At $400 Per Hour	Adjusted Cost Burden At $600 Per Hour
10-K	8,292	$1,840,481,319	$2,760,721,978
20-F	729	$576,824,025	$865,236,038
40-F	132	$17,084,560	$25,626,840

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. The following table summarizes the requested paperwork burden, including the

[551] *See* note 549. The table adjusts the average cost of retaining outside professionals from $400 to $600 per hour for the affected Exchange Act forms. The aggregate burden of Form N-CSR was last estimated, including to adjust for inflation, in 2021.

estimated total reporting burdens and costs, under the amendments. For purposes of the PRA, the requested change in burden hours in column H of PRA Table 6 is rounded to the nearest whole number.

PRA Table 6. Requested Paperwork Burden under the Final Amendments

	Current Burden			Program Change			Revised Burden		
Form	Current Annual Responses (A)	Current Burden Hours (B)	Adjusted Cost Burden (C)	Number of Affected Responses (D)	Change in Company Hours (E)	Change in Professional Costs (F)	Annual Responses (G)	Burden Hours (H) = (B) + (E)	Cost Burden (I) = (C) + (F)
Form 10-K	8,292	14,025,462	$2,760,721,978	4,513	5,592	$1,117,800	8,292	14,031,054	$2,761,839,778
Form 20-F	729	479,261	$865,236,038	722	297	$535,200	729	479,558	$865,771,238
Form 40-F	132	14,237	$25,626,840	132	57	$102,600	132	14,294	$25,729,440
Form N-CSR	6,898	181,167	$5,199,584	2,710	21	$4,200	6,898	181,188	$5,203,784

VI. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS

The Regulatory Flexibility Act requires the Commission, in promulgating rules under Section 553 of the Administrative Procedure Act,[552] to consider the impact of those rules on small entities. We have prepared this Final Regulatory Flexibility Analysis ("FRFA") in accordance with Section 604 of the RFA.[553] An Initial Regulatory Flexibility Analysis ("IRFA") was prepared in accordance with the RFA and was included in the Proposing Release.

[552] 5 U.S.C. 553.

[553] 5 U.S.C. 604.

A. Need for, and Objectives of, the Final Amendments

We are adopting amendments to implement the provisions of Section 954 of the Dodd-Frank Act, which added Section 10D to the Exchange Act. 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 final rules direct the exchanges to establish listing standards that require each issuer to adopt and comply with a policy providing for the recovery of erroneously awarded incentive-based compensation based on financial information required to be reported under the securities laws that is received by current or former executive officers. The final rules also require listed issuers to file their policies as an exhibit to their annual reports and to include other disclosures in the event a recovery analysis is triggered under the policy

As discussed in Section I, we read Section 954 to be motivated by a simple proposition: executives of listed issuers should not be entitled to retain incentive-based compensation that was erroneously awarded on the basis of misreported financial information. The statute thus mandates that listed issuers have policies in place to recover such compensation for the benefit of the issuer's owners—its shareholders. The language and legislative history of Section 954 makes clear that the provision is premised on the notion that an executive officer should not retain incentive-based compensation that, had the issuer's accounting been correct in the first instance, would not have been received by the executive, regardless of any fault of the executive officer for the accounting errors. Accordingly, under the final rules, listed issuers will be required to adopt a policy to recover erroneously awarded incentive-based compensation from

current or former executive officers regardless of whether those officers caused the material noncompliance or have direct responsibility for financial reporting matters. The disclosure requirements in the rules 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. The need for, and objectives of, the amendments are discussed in more detail in Sections I and II. We discuss the economic impact, including the estimated compliance costs and burdens, of the amendments in Sections IV and V.

B. Significant Issues Raised by Public Comments

In the Proposing Release, we requested comment on all aspects of the IRFA, including how the proposed rules could further lower the burden on small entities, the number of small entities that would be affected by the proposed rules, the existence or nature of the potential impact of the proposals on small entities discussed in the analysis, and how to quantify the impact of the proposed rules. We did not receive any comments specifically addressing the IRFA.[554] However, we received a number of comments on the proposed rules generally,[555] and have considered these comments in developing the FRFA. As noted in Section II.A.2., a number of commenters recommended that the Commission exempt or defer compliance for SRCs and EGCs citing the costs and burdens associated with imposing compensation recovery policies

[554] As discussed in *supra* note 14, one comment letter noted that the Commission did not update the RFA analysis in the Reopening Release, and urged the Commission to re-propose with an updated RFA analysis. *See* comment letter from Toomey/Shelby.

[555] *See* Sections II and IV.

containing the detail and scope contemplated by the proposal.[556] Other commenters expressed support for requiring recovery by SRCs and EGCs as proposed.[557]

C. Small Entities Subject to the Final Amendments

The final amendments will affect, among other entities, small entities that list securities on U.S.-registered securities exchanges. The RFA defines "small entity" to mean "small business," "small organization," or "small governmental jurisdiction."[558] For purposes of the RFA, under our rules, an issuer, other than an investment company, is 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.[559] The final amendments will 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 126 listed issuers, other than registered investment companies, that may be considered small entities.[560] Under 17 CFR 270.0-10, an investment company, including a

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[556] *See, e.g.,* comment letters from ABA 1; CCMC 2; Compensia; Hunton; Mercer; and NACD. Some commenters additionally recommended exempting SRCs and EGCs from the XBRL tagging requirements in view of the burden of preparing disclosure in XBRL format. *See* Section II.D.2. and comment letters from ABA 1; and Hay Group.

[557] *See, e.g.,* comment letters from Better Markets 1; CalPERS 1; CFA Institute 1; Public Citizen 1; and SBA.

[558] 5 U.S.C. 601(6).

[559] *See* 17 CFR 230.157 under the Securities Act and 17 CFR 240.0-10(a) under the Exchange Act. When referring to an exchange, the term "small business" or "small organization" means any exchange that: (1) has been exempted from the reporting requirements of 17 CFR 242.601; and is not affiliated with any person (other than a natural person) that is not a small business or small organization. *See* 17 CFR 240.0-10(e). No exchanges meet these criteria.

[560] These estimates are based on staff analysis of issuers potentially subject to the final amendments, excluding co-registrants, with EDGAR filings on Form 10-K, or amendments thereto, filed during the calendar year of Jan. 1, 2020 to Dec. 31, 2020, or filed by Sept. 1, 2021, that, if timely filed by the applicable deadline, would have been filed between Jan. 1 and Dec. 31, 2020. Analysis is based on data from XBRL filings, Compustat, Ives Group Audit Analytics, and manual review of filings submitted to the Commission. We further note that in the Proposing Release we estimated that there were 61 listed issuers. While the number of issuers in our current estimate reflects an increase from 61 to 126 listed issuers, we further estimate that 89 of the 126 listed issuers are SPACs. In the past two years, the U.S. securities markets have experienced an unprecedented surge in the number of initial public offerings by SPACs, with SPACs initially raising more than $83 billion in 2020 and

business development company, is considered to be a small entity 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. We estimate that there are approximately three listed investment companies, including business development companies, that may be considered small entities that may be affected by the final amendments.

D. Projected Reporting, Recordkeeping, and other Compliance Requirements

As noted above, the purpose of the final rules is to implement Section 10D of the Exchange Act by directing the exchanges to prohibit the listing of any security of an issuer that does not comply with listing standards regarding the development and implementation of a policy requiring recovery of erroneously awarded incentive-based compensation, and to require issuers to file all disclosure with respect to that policy in accordance with Commission rules. Rule 10D-1 requires exchanges to adopt listing standards that 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. As described in more detail above, the final rules also require issuers listed on an exchange to: file their written erroneously awarded compensation recovery policy as an exhibit to their annual reports; indicate by check boxes on the cover page of their annual

more than $160 billion in 2021, compared to $13.6 billion in in 2019 and $10.8 billion in 2018. Some of these small entities that are SPACs are unlikely to remain small entities once the SPAC has completed its intended business combination and becomes an operating rather than a shell company.

reports whether the financial statements of the registrant included in the filing reflect correction of an error to previously issued financial statements and whether any of those error corrections are restatements that required a recovery analysis; and disclose actions an issuer has taken pursuant to such recovery policy. These disclosures will also be required to be provided in tagged data language using Inline XBRL.

Small entities that are listed issuers will be subject to the same recovery and disclosure requirements as other listed issuers. These requirements are discussed in detail in Section II.

Developing and implementing the recovery policy mandated by the final amendments will impose compliance costs on small entities. The amendments may also involve the use of professional skills, such as legal, accounting, or technical skills. For example, listed issuers may engage the professional services of attorneys, accountants, and/or executive compensation consultants to develop their recovery policies and may use the services of those professionals to implement those policies in the event of an accounting restatement. Such services may 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 in connection with the collection, recording, and reporting of disclosures required under the rules. In addition, these entities will incur costs to tag the required disclosures in Inline XBRL and may engage the services of outside professionals to assist with this process. We discuss the economic effects, including the estimated costs and burdens, of the final amendments on all registrants, including small entities, in Sections IV and V.

As noted in Section IV, there is evidence that companies that are 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 listed issuers that

are small entities.[561] This may imply that, relative to other issuers, the final rules may cause executive officers at small entities to devote proportionately more internal resources to financial reporting and incur a greater proportional compliance burden than larger issuers. In addition, to the extent that a recovery policy reduces the incentive of an executive officer of a small entity to invest in certain value-enhancing projects that may increase the likelihood of a material accounting error, this may have a larger impact on the market value of equity of smaller entities whose valuation may be driven more by future prospects than by the value of current assets.[562]

However, we believe that the impact of the amendments on small entities overall will be mitigated because the rules 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 affected small entities. Further, as noted in Section IV, the effects of implementing a recovery policy could be lower on small entities relative to other issuers to the extent that small entities use a lower proportion of incentive-based compensation than other issuers. Analysis by Commission staff finds evidence that SRCs (and small entities that are SRCs), on average, use a lower proportion of incentive-based compensation than non-SRCs, suggesting a lower potential impact of the final rules on SRCs and small entities.[563]

E. Agency Action to Minimize Effect on Small Entities

The RFA directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. Accordingly, we considered the following alternatives:

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[561] *See* note 504 and accompanying text.

[562] *See* note 506 and accompanying text.

[563] *See supra* note 503 and accompanying text.

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

The amendments do not provide simplified compliance and reporting requirements, an exemption, or otherwise establish alternative compliance, reporting requirements, or timetables for small entities. As noted in Section I, Section 10D's purpose is straightforward: to recover incentive-based compensation that was erroneously awarded to executives at listed companies on the basis of misreported financial information. We see no reason why the shareholders of listed issuers that are small entities should not be entitled to recover compensation that was erroneously awarded to executives on the basis of such misreported information. Like other listed issuers, these entities will have flexibility to forgo recovery in circumstances where the direct expense paid to a third party to assist in enforcing recovery would exceed the recoverable amounts and will not be required to have a recovery policy in place until more than a year after the final amendments are published in the Federal Register. Moreover, while the final rules may impose a greater proportional compliance burden on small entities, as discussed in Section IV, the benefits of the final rules may be particularly salient for small entities as evidence suggests that they may have an increased likelihood of reporting an accounting error and may be more likely to report a material weakness in internal control over financial reporting.

The recovery requirement may also provide executive officers with an increased incentive to improve the overall quality and reliability of the issuer's financial reporting. As

noted in Section IV, small entities may have an increased likelihood of reporting an accounting error and may be more likely to report a material weakness in internal control over financial reporting, due to their smaller size relative to larger entities.[564] For all of these reasons, we do not believe it would be appropriate to establish alternative compliance requirements or exempt small entities from the scope of the mandatory recovery provisions.

The final amendments further require the filing of a listed issuer's policy on recovery of incentive-based compensation, and clear disclosure to provide shareholders with useful information regarding the application of that policy. By requiring such disclosure, the final amendments will help promote consistent compliance with recovery obligations and related disclosure across all listed issuers. Because the filing of the recovery policy is not costly for issuers and provides a way for investors to understand the means by which an issuer is complying with the requirements, we do not believe the marginal cost savings to small entities warrants an exemption from this requirement. Further, we note that the additional disclosures with respect to the application of the policy would only be required in the event of a restatement due to material noncompliance with financial reporting requirements, and we believe it is necessary in these circumstances for investors to understand the implications of the restatement and the issuer's application of its policy, regardless of the size of the entity.

Finally, some aspects of the final rules use performance standards. Specifically, Rule 10D-1 uses a principles-based definition of "incentive-based compensation," provides boards of directors with discretion in determining the means of recovery, and uses a principles-based approach to determining the amount of incentive-based compensation subject to recovery. These aspects of the final rules may make it easier for small entities to apply the mandatory recovery

[564] *See* note 520.

policy in the context of their own facts and circumstances. However, many other aspects of the final rules, in particular the disclosure requirements, use design standards in order to promote consistent information and recovery practices across listed issuers, in keeping with what we understand to be Congress's objective in enacting Section 10D.

STATUTORY AUTHORITY

The amendments contained in this release are being adopted under the authority set forth in Sections 6, 7, 10, and 19(a) of the Securities Act; Sections 3(b), 10D, 12, 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, 232, 240, 249, 270, and 274

Reporting and recordkeeping requirements, Securities, Investment companies.

TEXT OF RULE AMENDMENTS

In accordance with the foregoing, the Commission amends 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 authority citation for part 229 continues 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; sec. 953(b), Pub. L. 111-203, 124 Stat. 1904 (2010); and sec. 102(c), Pub. L. 112-106, 126 Stat. 310 (2012).

2. Amend §229.402 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) *General.*

(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 249.220f), 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 (19) of General Instruction B of Form 40-F (17 CFR 249.240f), as applicable. A foreign private issuer that elects to provide domestic Item 402 disclosure must provide the disclosure required by Item 402(w) in its annual report or registration statement, as applicable.

* * * * *

(c) * * *

Instructions to Item 402(c). * * *

5. 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 by any

amounts recovered pursuant to a registrant's compensation recovery policy required by the listing standards adopted pursuant to 17 CFR 240.10D-1, and identify such amounts by footnote.

* * * * *

(n) * * *

Instructions to Item 402(n). * * *

5. 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 by any amounts recovered pursuant to the compensation recovery policy required by the listing standards adopted pursuant to 17 CFR 240.10D-1, and identify such amounts by footnote.

* * * * *

(w) *Disclosure of a registrant's action to recover erroneously awarded compensation*.

(1) If at any time during or after the last completed fiscal year the registrant was required to prepare an accounting restatement that required recovery of erroneously awarded compensation pursuant to the registrant's compensation recovery policy required by the listing standards adopted pursuant to 17 CFR 240.10D-1, or there was an outstanding balance as of the end of the last completed fiscal year of erroneously awarded compensation to be recovered from the application of the policy to a prior restatement, the registrant must provide the following information:

(i) For each restatement:

(A) The date on which the registrant was required to prepare an accounting restatement;

(B) The aggregate dollar amount of erroneously awarded compensation attributable to such accounting restatement, including an analysis of how the amount was calculated;

(C) If the financial reporting measure as defined in 17 CFR 240.10D-1(d) related to a stock price or total shareholder return metric, the estimates that were used in determining the erroneously awarded compensation attributable to such accounting restatement and an explanation of the methodology used for such estimates;

(D) The aggregate dollar amount of erroneously awarded compensation that remains outstanding at the end of the last completed fiscal year; and

(E) If the aggregate dollar amount of erroneously awarded compensation has not yet been determined, disclose this fact, explain the reason(s) and disclose the information required in (B) through (D) in the next filing that is required to include disclosure pursuant to Item 402 of Regulation S-K;

(ii) If recovery would be impracticable pursuant to 17 CFR 240.10D-1(b)(1)(iv), for each current and former named executive officer and for all other current and former executive officers as a group, disclose the amount of recovery forgone and a brief description of the reason the listed registrant decided in each case not to pursue recovery; and

(iii) For each current and former named executive officer from whom, as of the end of the last completed fiscal year, erroneously awarded compensation had been outstanding for 180 days or longer since the date the registrant determined the amount the individual owed, disclose the dollar amount of outstanding erroneously awarded compensation due from each such individual.

(2) If at any time during or after its last completed fiscal year the registrant was required to prepare an accounting restatement, and the registrant concluded that recovery of erroneously awarded compensation was not required pursuant to the registrant's compensation recovery policy required by the listing standards adopted pursuant to 17 CFR 240.10D-1, briefly explain why application of the recovery policy resulted in this conclusion.

(3) The information must appear with, and in the same format as, the rest of the disclosure required to be provided pursuant to this Item 402. The information is required only in proxy or information statements that call for Item 402 disclosure and the registrant's annual report on Form 10-K, and 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.

(4) The disclosure must be provided in an Interactive Data File in accordance with Rule 405 of Regulation S-T and the EDGAR Filer Manual.

* * * * *

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), to read 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 erroneously awarded compensation computed as provided in 17 CFR 240.10D-1(b)(1)(iii) and the applicable listing standards for the registrant's securities, that is disclosed pursuant to Item 402(w) (§229.402(w)).

* * * * *

4. Amend §229.601 by

a. Adding paragraph (97) to the exhibit table in paragraph (a); and

b. Adding paragraph (b)(97).

The revision and addition 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

* * * * * * *

(97) ***Policy Relating to Recovery of Erroneously Awarded Compensation***															X	
(98) [Reserved]																

* * * * * * *

* * * * *

(b) * * *

(97) *Policy Relating to Recovery of Erroneously Awarded Compensation*. A registrant that at any time during its last completed fiscal year 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) must file as an exhibit to its annual report the compensation recovery policy required by the applicable listing standards adopted pursuant to 17 CFR 240.10D-1.

* * * * *

PART 232 — REGULATION S-T — GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

5. The general authority citation for part 232 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77f, 77g, 77h, 77j, 77s(a), 77z-3, 77sss(a), 78c(b), 78*l*, 78m, 78n, 78o(d), 78w(a), 78*ll*, 80a-6(c), 80a-8, 80a-29, 80a-30, 80a-37, 80b-4, 80b-6a, 80b-10, 80b-11, 7201 *et seq*.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

6. Amend § 232.405 by:

a. Removing the word "or" at the end of paragraph (b)(2)(iii);

b. Removing the period at the end of paragraph (b)(2)(iv) and adding "; or" in its place;

c. Adding paragraph (b)(2)(v);

d. Removing paragraph (b)(3)(i)(C);

e. Removing the word "and" at the end of paragraph (b)(3)(ii);

f. Removing the period at the end of paragraph (b)(3)(iii) and adding "; and" in its place;

g. Adding paragraph (b)(3)(iv);

h. Removing the period at the end of paragraph (b)(4)(i) and adding "and" in its place; and

i. Adding paragraph (b)(4)(ii).

The revisions and additions read as follows:

§ 232.405 Interactive Data File Submissions.

* * * * *

(b) * * *

(2) * * *

(v) Any disclosure provided in response to Item 18 of §§ 249.331 and 274.128 of this chapter (Form N-CSR), as applicable.

(3) * * *

(iv) As applicable, the disclosure set forth in paragraph (b)(4) of this section.

(4) * * *

(i) Section 229.402(v) of this chapter (Item 402(v) of Regulation S-K); and

(ii) Any disclosure provided in response to: § 229.402(w) of this chapter (Item 402(w) of Regulation S-K); Item 6.F of § 249.220f of this chapter (Form 20-F); paragraph (19) of General Instruction B of §249.240f of this chapter (Form 40-F); and Item 18 of §§ 249.331 and 274.128 of this chapter (Form N-CSR).

* * * * *

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

7. The general 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, 78dd, 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); and Pub. L. 112-106, sec. 503 and 602, 126 Stat.326 (2012), unless otherwise noted.

* * * * *

8. Add an undesignated center heading following § 240.10C–1 to read as follows:

Requirements Under Section 10D

9. Add §240.10D-1 to read as follows:

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

(a) 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 exchange or association lists securities, must:

(1) 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 this section;

(2) No later than [INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER], propose rules or rule amendments that comply with this section. Such rules or rule amendments that comply with this section must be effective no later than one year after [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER];

(3) Require that each listed issuer:

(i) 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) of this section to which the issuer is subject;

(ii) Comply with that recovery policy for all incentive-based compensation received (as defined in paragraph (d) of this section) by executive officers on or after the effective date of the applicable listing standard;

(iii) Provide the disclosures required by this section and in the applicable Commission filings required on or after the effective date of the listing standard referenced in paragraph (a)(2) of this section to which the issuer is subject.

(b) *Recovery of Erroneously Awarded Compensation*. The issuer must:

(1) Adopt and comply with a written policy providing that the issuer will recover reasonably promptly the amount of erroneously awarded incentive-based compensation 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, including any required accounting restatement to correct an error in previously issued financial statements that is material to the previously issued financial statements, or that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period.

(i) The issuer's recovery policy must apply to all incentive-based compensation received by a person:

(A) After beginning service as an executive officer;

(B) Who served as an executive officer at any time during the performance period for that incentive-based compensation;

(C) While the issuer has a class of securities listed on a national securities exchange or a national securities association; and

(D) During the three completed fiscal years immediately preceding the date that the issuer is required to prepare an accounting restatement as described in paragraph (b)(1) of this section. In addition to these last three completed fiscal years, the recovery policy must 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 between the last day of the issuer's previous fiscal year end and the first day of its new fiscal year that comprises a period of nine to 12 months would be deemed a completed fiscal year. An issuer's obligation to recover erroneously awarded compensation is not dependent on if or when the restated financial statements are filed.

(ii) For purposes of determining the relevant recovery period, the date that an issuer is required to prepare an accounting restatement as described in paragraph (b)(1) of this section is the earlier to occur of:

(A) 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 is required to prepare an accounting restatement as described in paragraph (b)(1) of this section; or

(B) The date a court, regulator, or other legally authorized body directs the issuer to prepare an accounting restatement as described in paragraph (b)(1) of this section.

(iii) The amount of incentive-based compensation that must be subject to the issuer's recovery policy ("erroneously awarded compensation") is 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 restated amounts, and must 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 must 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 must 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 the conditions of paragraphs (b)(1)(iv)(A), (B), or (C) of this section are met, and 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, has made a determination that recovery would be impracticable.

(A) The direct expense paid to a third party to assist in enforcing the policy would exceed the amount to be recovered. Before concluding that it would be impracticable to recover any amount of erroneously awarded compensation based on expense of enforcement, the issuer must make a reasonable attempt to recover such erroneously awarded compensation, document such reasonable attempt(s) to recover, and provide that documentation to the exchange or association.

(B) Recovery would violate home country law where that law was adopted prior to [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]. 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,

acceptable to the applicable national securities exchange or association, that recovery would result in such a violation, and must provide such opinion to the exchange or association.

(C) Recovery would likely cause an otherwise tax-qualified retirement plan, under which benefits are broadly available to employees of the registrant, to fail to meet the requirements of 26 U.S.C. 401(a)(13) or 26 U.S.C. 411(a) and regulations thereunder.

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

(2) File all disclosures with respect to such recovery policy in accordance with the requirements of the Federal securities laws, including the disclosure required by the applicable Commission filings.

(c) *General Exemptions*. The requirements of this section do not apply to the listing of:

(1) 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));

(2) A standardized option, as defined in 17 CFR 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);

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

(4) 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.

(d) *Definitions*. Unless the context otherwise requires, the following definitions apply for purposes of this section:

Executive Officer. 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 are 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. Policy-making function is not intended to include policy-making functions that are not significant. Identification of an executive officer for purposes of this section would include at a minimum executive officers identified pursuant to 17 CFR 229.401(b).

Financial Reporting Measures. Financial reporting measures are measures that are determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements, and any measures that are derived wholly or in part from such measures. Stock price and total shareholder return are also financial reporting measures. A financial reporting measure need not be presented within the financial statements or included in a filing with the Commission.

Incentive-Based Compensation. *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.

Received. 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.

10. Amend Section 240.14a-101, by adding Item 22(b)(20) 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 the Fund was required to prepare an accounting restatement that required recovery of erroneously awarded compensation pursuant to the Fund's compensation recovery policy required by the listing standards adopted pursuant to 240.10D-1, or there was an outstanding balance as of the end of the last completed fiscal year of erroneously awarded compensation to be recovered from the application of the policy to a prior restatement, the Fund must provide the information required by Item 18 of Form N-CSR, as applicable.

* * * * *

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

11. The authority citation for part 249 continues to read, in part, as follows:

Authority: 15 U.S.C. 78a *et seq*., and 7201 *et seq*.; 12 U.S.C. 5461 *et seq*.; 18 U.S.C. 1350; Sec. 953(b) Pub. L. 111-203, 124 Stat. 1904; Sec. 102(a)(3) Pub. L. 112-106, 126 Stat. 309 (2012), Sec. 107 Pub. L. 112-106, 126 Stat. 313 (2012), Sec. 72001 Pub. L. 114-94, 129 Stat. 1312 (2015), and secs. 2 and 3 Pub. L. 116-222, 134 Stat. 1063 (2020), unless otherwise noted.

* * * * *

Section 249.220f is also issued under secs. 3(a), 202, 208, 302, 306(a), 401(a), 401(b), 406 and 407, Pub. L. 107-204, 116 Stat. 745, and secs. 2 and 3, Pub. L. 116-222, 134 Stat. 1063.

Section 249.240f is also issued under secs. 3(a), 202, 208, 302, 306(a), 401(a), 406 and 407, Pub. L. 107-204, 116 Stat. 745.

* * * * *

Section 249.310 is also issued under secs. 3(a), 202, 208, 302, 406 and 407, Pub. L. 107-204, 116 Stat. 745.

* * * * *

12. Amend Form 20-F (referenced in §249.220f) by:

a. Adding the text and check boxes to the cover page immediately before the text "Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing";

b. Adding Item 6.F.;

c. Adding Instruction 4. to the Instructions to Item 7.B.; and

d. Adding Instruction 97 to the Instructions as to Exhibits.

The revisions and additions 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

* * * * *

If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements. □

Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period pursuant to §240.10D-1(b). □

* * * * *

Item 6. Directors, Senior Management and Employees

* * * * *

F. ***Disclosure of a registrant's action to recover erroneously awarded compensation*****.**

(1) If at any time during or after the last completed fiscal year the registrant was required to prepare an accounting restatement that required recovery of erroneously awarded compensation pursuant to the registrant's compensation recovery policy required by the listing standards adopted pursuant to 17 CFR 240.10D-1, or there was an outstanding balance as of the end of the last completed fiscal year of erroneously awarded compensation to be recovered from the application of the policy to a prior restatement, the registrant must, in its annual report on Form 20-F, provide the following information:

(i) For each restatement:

(A) The date on which the registrant was required to prepare an accounting restatement;

(B) The aggregate dollar amount of erroneously awarded compensation attributable to such accounting restatement, including an analysis of how the amount was calculated;

(C) If the financial reporting measure as defined in 17 CFR 240.10D-1(d) related to a stock price or total shareholder return metric, the estimates that were used in determining the erroneously awarded compensation attributable to such accounting restatement and an explanation of the methodology used for such estimates;

(D) The aggregate dollar amount of erroneously awarded compensation that remains outstanding at the end of the last completed fiscal year; and

(E) If the aggregate dollar amount of erroneously awarded compensation has not yet been determined, disclose this fact, explain the reason(s) and disclose the information required in (B) through (D) in the next filing that is subject to this Item;

(ii) If recovery would be impracticable pursuant to 17 CFR 240.10D-1(b)(1)(iv), for each current and former named executive officer and for all other current and former executive officers as a group, disclose the amount of recovery forgone and a brief description of the reason the listed registrant decided in each case not to pursue recovery; and

(iii) For each current and former named executive officer from whom, as of the end of the last completed fiscal year, erroneously awarded compensation had been outstanding for 180 days or longer since the date the registrant determined the amount the individual owed, disclose the dollar amount of outstanding erroneously awarded compensation due from each such individual.

(2) If at any time during or after its last completed fiscal year the registrant was required to prepare an accounting restatement, and the registrant concluded that recovery of erroneously awarded compensation was not required pursuant to the registrant's compensation recovery

policy required by the listing standards adopted pursuant to 17 CFR 240.10D-1, briefly explain why application of the recovery policy resulted in this conclusion;

(3) The information must appear with, and in the same format as, the rest of the disclosure required to be provided pursuant to this Item 6, is required only in annual reports and does not apply to registration statements on Form 20-F, and 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; and

(4) The disclosure must be provided in an Interactive Data File in accordance with Rule 405 of Regulation S-T and the EDGAR Filer Manual.

* * * * *

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

* * * * *

97. A registrant that at any time during its last completed fiscal year 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) must file as an exhibit to its annual report on Form

20-F the compensation recovery policy required by the applicable listing standards adopted pursuant to 17 CFR 240.10D-1.

17 through 96 and 98 through 99 [Reserved]

* * * * *

13. Amend Form 40-F (referenced in §249.240f) by adding the text and check boxes to the cover page immediately before the heading "General Instructions" and adding paragraph (19) to 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

* * * * *

If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements. □

Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period pursuant to §240.10D-1(b). □

* * * * *

B. Information to be Filed on this Form

* * * * *

(19) Recovery of erroneously awarded compensation.

(a) A registrant that at any time during its last completed fiscal year 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) must file as exhibit 97 to its annual report on Form 40-F the compensation recovery policy required by the applicable listing standards adopted pursuant to 17 CFR 240.10D-1.

(b) If at any time during or after the last completed fiscal year the registrant was required to prepare an accounting restatement that required recovery of erroneously awarded compensation pursuant to the registrant's compensation recovery policy required by the listing standards adopted pursuant to 17 CFR 240.10D-1, or there was an outstanding balance as of the end of the last completed fiscal year of erroneously awarded compensation to be recovered from the application of the policy to a prior restatement, the registrant must, in its annual report on Form 40-F, provide the following information:

(1) For each restatement:

(i) The date on which the registrant was required to prepare an accounting restatement;

(ii) The aggregate dollar amount of erroneously awarded compensation attributable to such accounting restatement, including an analysis of how the amount was calculated;

(iii) If the financial reporting measure as defined in 17 CFR 10D-1(d) related to a stock price or total shareholder return metric, the estimates that were used in determining the erroneously awarded compensation attributable to such accounting restatement and an explanation of the methodology used for such estimates;

(iv) The aggregate dollar amount of erroneously awarded compensation that remains outstanding at the end of the last completed fiscal year; and

(v) If the aggregate dollar amount of erroneously awarded compensation has not yet been determined, disclose this fact, explain the reason(s) and disclose the information required in (ii) through(iv) in the next filing that is subject to this paragraph 19;

(2) If recovery would be impracticable pursuant to 17 CFR 240.10D-1(b)(1)(iv), for each current and former named executive officer and for all other current and former executive officers as a group, disclose the amount of recovery forgone and a brief description of the reason the listed registrant decided in each case not to pursue recovery; and

(3) For each current and former named executive officer from whom, as of the end of the last completed fiscal year, erroneously awarded compensation had been outstanding for 180 days or longer since the date the registrant determined the amount the individual owed, disclose the dollar amount of outstanding erroneously awarded compensation due from each such individual.

(c) If at any time during or after its last completed fiscal year the registrant was required to prepare an accounting restatement, and the registrant concluded that recovery of erroneously awarded compensation was not required pursuant to the registrant's compensation recovery policy required by the listing standards adopted pursuant to 17 CFR 240.10D-1, briefly explain why application of the recovery policy resulted in this conclusion;

(d) The information must appear with, and in the same format as generally required for, the rest of the disclosure required to be provided pursuant to General Instruction B, is required only in annual reports and does not apply to registration statements on Form 40-F, and 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; and

(e) The disclosure must be provided in an Interactive Data File in accordance with Rule 405 of Regulation S-T and the EDGAR Filer Manual.

* * * * *

14. Amend Form 10-K (referenced in §249.310) by adding a field to the cover page to include the text and check boxes immediately before the text "Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act)" to read as follows:

Note: The text of Form 10-K does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM 10-K

* * * * *

If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements. □

Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period pursuant to §240.10D-1(b). □

* * * * *

PART 270 — RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

15. The authority citation for part 270 continues to read, in part, as follows:

Authority: 15 U.S.C. 80a-1 *et seq.*, 80a-34(d), 80a-37, 80a-39, and Pub. L. 111-203, sec. 939A, 124 Stat. 1376 (2010), unless otherwise noted.

* * * * *

Section 270.30a-2 is also issued under 15 U.S.C. 78m, 78o(d), 80a-8, 80a-29, 7202, and 7241; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

16. Amend § 270.30a-2 by revising it to read as follows:

§ 270.30a-2 Certification of Form N-CSR.

(a) Each report filed on Form N-CSR (§§ 249.331 and 274.128 of this chapter) by a registered management investment company must include certifications in the form specified in Item 19(a)(3) of Form N-CSR, and such certifications must be filed as an exhibit to such report. Each principal executive and principal financial officer of the investment company, or persons performing similar functions, at the time of filing of the report must sign a certification.

(b) Each report on Form N-CSR filed by a registered management investment company under Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) and that contains financial statements must be accompanied by the certifications required by Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350) and such certifications must be furnished as an exhibit to such report as specified in Item 19(b) of Form N-CSR. Each principal executive and principal financial officer of the investment company (or equivalent thereof) must sign a certification. This requirement may be satisfied by a single certification signed by an investment company's principal executive and principal financial officers.

PART 274 — FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

17. The authority citation for part 274 is revised to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78*l*, 78m, 78n, 78*o*(d), 80a-8, 80a-24, 80a-26, 80a-29, and 80a-37 unless otherwise noted.

Section 274.128 is also issued under 15 U.S.C. 78j-1, 7202, 7233, 7241, 7264, and 7265; and 18 U.S.C. 1350.

18. Amend Form N-CSR (referenced in 17 CFR 274.128) by:

a. Revising General Instruction D;

b. Redesignating Item 18 as Item 19;

c. Redesignating the instructions to Item 18 as instructions to Item 19;

d. Adding new Item 18;

e. Redesignating paragraph (a)(2) of newly designated Item 19 (Exhibits) as paragraph (a)(3);and

f. Adding paragraph (a)(2) to newly designated Item 19 (Exhibits).

The revisions and 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

* * * * *

D. Incorporation by Reference.

A registrant may incorporate by reference information required by Items 4, 5, 18, 19(a)(1), and 19(a)(2). No other Items of the Form shall be answered by incorporating any information by reference. The information required by Items 4, 5, and 18 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.)) involving 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 303 of Regulation S-T (17 CFR 232.303) (specific requirements for electronically filed documents); Rule 12b-23 under the Exchange Act (17 CFR 240.12b-23) (additional rules on incorporation by reference for reports filed pursuant to Sections 13 and 15(d) of the Exchange Act); and Rule 0-4 under the Investment Company Act of 1940 (17 CFR 270.0-4) (additional rules on incorporation by reference for investment companies).

* * * * *

Item 18. Recovery of Erroneously Awarded Compensation.

(a) If at any time during or after the last completed fiscal year the registrant was required to prepare an accounting restatement that required recovery of erroneously awarded compensation pursuant to the registrant's compensation recovery policy required by the listing standards adopted pursuant to 17 CFR 240.10D-1, or there was an outstanding balance as of the end of the last completed fiscal year of erroneously awarded compensation to be recovered from the application of the policy to a prior restatement, the registrant must provide the following information:

(1) For each restatement:

(i) The date on which the registrant was required to prepare an accounting restatement;

(ii) The aggregate dollar amount of erroneously awarded compensation attributable to such accounting restatement, including an analysis of how the amount was calculated;

(iii) If the financial reporting measure defined in 17 CFR 10D-1(d) related to a stock price or total shareholder return metric, the estimates that were used in determining the erroneously awarded compensation attributable to such accounting restatement and an explanation of the methodology used for such estimates;

(iv) The aggregate dollar amount of erroneously awarded compensation that remains outstanding at the end of the last completed fiscal year; and

(v) If the aggregate dollar amount of erroneously awarded compensation has not yet been determined, disclose this fact, explain the reason(s) and disclose the information required in (ii) through (iv) in the next annual report that the registrant files on this Form N-CSR;

(2) If recovery would be impracticable pursuant to 17 CFR 10D-1(b)(1)(iv), for each named executive officer and for all other executive officers as a group, disclose the amount of recovery forgone and a brief description of the reason the registrant decided in each case not to pursue recovery; and

(3) For each named executive officer from whom, as of the end of the last completed fiscal year, erroneously awarded compensation had been outstanding for 180 days or longer since the date the registrant determined the amount the individual owed, disclose the dollar amount of outstanding erroneously awarded compensation due from each such individual.

(b) If at any time during or after its last completed fiscal year the registrant was required to prepare an accounting restatement, and the registrant concluded that recovery of erroneously awarded compensation was not required pursuant to the registrant's compensation recovery policy required by the listing standards adopted pursuant to 17 CFR 240.10D-1, briefly explain why application of the recovery policy resulted in this conclusion.

Item 19. 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).

Instruction to paragraph (a)(2).

The exhibit required by this paragraph (a)(2) is only required in an annual report on Form N-CSR.

* * * * *

By the Commission.

Dated: October 26, 2022.

Vanessa A. Countryman,

Secretary.