Americans for Financial Reform Education Fund

July 6, 2022

Vanessa A. Countryman
Securities and Exchange Commission
100 F St. NE
Washington, DC 20549

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

Dear Secretary Countryman,

The Americans for Financial Reform Education Fund (AFREF) appreciates the opportunity to comment on the proposal of the Securities and Exchange Commission (the Commission) to implement Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

We welcome and support this proposed rule, which, once finalized, will signify the long-overdue implementation of a Dodd-Frank provision that sought to improve incentives for honest and transparent corporate governance by creating a mechanism for the clawing back of compensation awarded based on inaccurate financial statements. AFREF submitted a comment in support of the proposed rule in 2015,[1] and submits this additional comment to answer questions raised by the Commission upon reopening the comment period.

1. As newly proposed, "an accounting restatement due to material noncompliance" should be interpreted to include all required restatements made to correct an error in previously issued financial statements.

In the years since the initial rule was proposed, the Commission has gotten a concrete glimpse into how regulated parties might change their behavior to minimize the intended effects

[1] Americans for Financial Reform Education Fund's Comment letter to the SEC on Listing Standards for Recovery of Erroneously Awarded Compensation, Sept. 14, 2015, *available at* https://www.sec.gov/comments/s7-12-15/s71215-50.pdf.

of the rule and the underlying statute it seeks to implement. AFREF supports the Commission's proposal, responsive to these developments, to strengthen the rule by including "little r" restatements—restatements of a company's past financial statements the next time they are presented without a formal reissuance of the previous statement or a filing of an Item 4-2 8-K—as triggers for clawback analyses in addition to "Big R" restatements.

In the years since the Commission first proposed the rule, there has been an uptick in both company adoption of clawback policies and "little r" restatements. Importantly, there is evidence that "little r" restatements have been issued in lieu of "Big R" restatements to avoid clawbacks. One study found that a third of "little r" restatements were "suspect" because they met at least one of the criteria for a "Big R" restatement.[2] Additionally, the study found that companies with clawback policies triggered by "Big R" restatements were much more likely to issue "suspect" "little R" restatements.[3] Two years earlier, in 2019, the Wall Street Journal reported on another study with similar results: nearly half of "little r" restatements had at least one characteristic indicating they should have been "Big R" restatements, and companies with clawback policies triggered by "Big R" restatements were more than twice as likely as other companies to use "little r" restatements for potentially material changes.[4]

In light of these documented trends, it is clear that the Commission must include "little r" restatements in its interpretation of "an accounting restatement due to material noncompliance" to effectively implement both the letter and the spirit of section 954 of Dodd-Frank.

2. <u>The Commission should not remove the "reasonably should have concluded" standard from the rule.</u>

The Commission's original proposal included two triggers for the three-year clawback lookback period. The trigger that would apply in the vast majority of cases would be the one when the issuer "concludes, or reasonably should have concluded, that the issuer's previously issued financial statements contain a material error." Through its reopening release, the Commission asks whether it should remove the "reasonably should have concluded" standard from the rule. We believe that it should not.

If the Commission were to remove the "reasonably should have concluded" standard, it would create an incentive for the issuer to delay taking action necessary to fix erroneous financial statements to minimize the effects of the clawback analysis. It is reasonable to believe

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[2] Rachel Thompson, "Reporting Misstatements as Revisions: An Evaluation of Managers' Use of Materiality Discretion," 2, Sept. 17 2021, *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3450828.
[3] *Id*. at 3.
[4] Jean Eaglesham, "Shh! Companies Are Fixing Accounting Errors Quietly," Wall Street Journal, Dec. 5, 2019, *available at* https://www.wsj.com/articles/shh-companies-are-fixingaccounting-errors-quietly-11575541981.

that this incentive would result in less erroneously-awarded compensation being clawed back and less accurate financial statements—both of which would hurt investors and the integrity of the financial system as a whole.

3. The Commission should require disclosure of how issuers calculated the recoverable amount and add checkboxes to the cover page of the Form 10-K that disclose "little r" restatements and their impact on clawbacks.

In its original proposal in 2015, the Commission did not propose requiring disclosure of how issuers calculated the recoverable amount of a clawback, but it is proposing adding this requirement now. AFREF strongly supports adding this important layer of transparency. Calculating the clawback amount—especially since executives receive a substantial amount of their compensation in equity—will often be a complicated, imprecise process. Issuers will arguably often have an incentive to minimize the clawback amount, while investors and other market participants have an interest in a fair, unbiased calculation that truly remedies wrongly-awarded compensation. Transparency in the calculation will better align the incentives of those calculating the recoverable amount with the interests of investors and increase accountability.

Similarly, AFREF supports the Commission's new proposal to increase disclosure to investors and the public through the inclusion of checkboxes in the cover page of Form 10-K that would make clear whether the previously issued financial statements included in the filing include an error correction, and whether any of those corrections triggered a clawback analysis. This information is important for investors and the public because otherwise, "little r" restatements and ensuing clawback analyses would be more difficult to identify, increasing the costs of ensuring issuers are abiding by the clawback rules.

We appreciate the Commission's consideration of our recommendations to make the rule as effective as possible. For further discussion, please contact Natalia Renta at natalia@ourfinancialsecurity.org.

Sincerely,

Americans for Financial Reform Education Fund