

MEMO# 33831

October 18, 2021

SEC Reopens Comment Period on Its 2015 Clawback Proposal

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TO: Accounting/Treasurers Committee
Closed-End Investment Company Committee
ETF (Exchange-Traded Funds) Committee
ETF Advisory Committee
SEC Rules Committee
Small Funds Committee
Unit Investment Trust Committee RE: SEC Reopens Comment Period on Its 2015 Clawback Proposal

Last week, the SEC reopened the comment period for its 2015 clawback proposal,[\[1\]](#) which it never adopted. This will allow further opportunity to analyze and comment on the proposal in light of developments since its publication.

Comments are due 30 days after the release is published in the *Federal Register*. ICI likely will submit a short comment letter in response, reiterating the points made in our 2015 comment letter (see below for a summary). If you have feedback or comments—either on the proposal or the latest release—please reach out to me (matt.thornton@ici.org).

Background and Summary of the Proposal

In July 2015, the SEC proposed a new rule and form amendments to implement the provisions of Section 954 of the Dodd-Frank Act.[\[2\]](#) Section 954 added Section 10D to the Securities Exchange Act of 1934 (the "Exchange Act"). Section 10D requires the SEC to adopt rules directing the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that does not develop and implement a policy providing for:

- disclosure of the issuer's policy on incentive-based compensation that is based on financial information reported under the securities laws; and
- recovery of incentive-based compensation that the issuer's executive officers receive during the preceding 3-year period in excess of what they would have received under an accounting restatement.

Proposed rule 10D-1 under the Exchange Act (the "Proposed Rule") would exempt the securities of most registered investment companies because "the compensation structures of issuers of these securities render application of the rule and rule amendments unnecessary."[\[3\]](#) The Proposed Rule and form amendments would apply only to those registered funds that:

- list their securities on an exchange (i.e., ETFs and closed-end funds);
- have internal management (i.e., have paid employees of their own, as opposed to relying on an investment adviser's employees, whom the adviser pays); and
- pay their executive officers incentive-based compensation.[\[4\]](#)

The Proposed Rule would require:

- each national securities exchange and national securities association that lists securities to file with the SEC, for approval, proposed rules that comply with any final SEC rule; and
- a listed issuer to adopt a written policy providing for the recovery of erroneously awarded incentive-based compensation to executive officers.

The preparation of an accounting restatement due to the issuer's material noncompliance with any financial reporting requirement under the securities laws would trigger application of the issuer's policy, and the policy would apply to all executive officers irrespective of fault.

The Proposed Rule contains detailed definitions of "accounting restatement," "material noncompliance," "incentive-based compensation," and "executive officer." It also contains detailed provisions about how to determine the relevant 3-year time period for measuring the incentive-based compensation subject to recovery; what constitutes "receipt" of incentive-based compensation; how to calculate erroneously awarded compensation (including that based on stock price or total shareholder return); and how to recover erroneously awarded compensation and determine whether recovery would be "impracticable." The Proposed Rule would prohibit an issuer from indemnifying executive officers against the loss of erroneously awarded compensation.

The proposal also would subject applicable funds to new disclosure requirements. Amended Form N-CSR would require these funds to provide annual disclosure about accounting restatements that required recovery of excess incentive-based compensation and file as exhibits their recovery policies. Amended Schedule 14A would require similar disclosure about accounting restatements and recoveries in proxy statements and information statements relating to the election of directors.

Summary of ICI's 2015 Comment Letter

In our comment letter,[\[5\]](#) we supported the SEC's determination to exclude most registered investment companies from the proposal. We recommended, however, that the SEC exclude all registered investment companies. In support of this recommendation, we make the following points:

- The concerns behind this Dodd-Frank Act provision do not apply to listed funds;
- The SEC excluded all registered investment companies from certain prior compensation-related rulemakings;
- Listed funds' financial statements and accounting practices are less complex than those of operating companies; and

- Costs of implementation and compliance will outweigh any benefits.

Summary of the 2021 Release

The 2021 release asks a series of questions about technical aspects of the proposal, including its definitions of "accounting restatement" and "material noncompliance;" triggering events for the 3-year look-back period; aspects of clawback policies that have been voluntarily adopted; calculations of recoverable amounts; and XBRL tagging of compensation recovery disclosures.

The release also asks a handful of questions about how the proposal relates to funds and BDCs. For instance, it asks whether:

- There have been any changes or developments with respect to payment of incentive-based compensation by listed funds that should affect their treatment;
- The management structure (i.e., internal or external) of a fund or BDC should impact its treatment; and
- Listed BDCs (or externally managed listed BDCs) should be treated the same as listed funds and be eligible for the conditional exemption as long as they do not actually pay incentive-based compensation.

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endnotes

[1] *Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation*, SEC Release No. 33-10998 (Oct. 14, 2021), available at www.sec.gov/rules/proposed/2021/33-10998.pdf.

[2] *Listing Standards for Recovery of Erroneously Awarded Compensation*, SEC Release No. 33-9861 (the "proposal") (July 1, 2015), available at www.sec.gov/rules/proposed/2015/33-9861.pdf. See Institute Memorandum [No. 29181](#), dated July 16, 2015, for a more complete summary of the proposal.

[3] Proposal at 11.

[4] The Proposed Rule expressly exempts UIT securities and "[a]ny security issued by a management company ... that is registered under section 8 of the Investment Company Act of 1940..., 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."

[5] Available at www.sec.gov/comments/s7-12-15/s71215-25.pdf.

abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.