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VIA Email (rule-comments@sec.gov)
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

September 14, 2015

RE: Listing Standards for Recovery of Erroneously Awarded Compensation — Mercer Comments (File Number S7-12-15)

To Whom It May Concern:

Mercer has reviewed the proposed rule on Listing Standards for Recovery of Erroneously Awarded Compensation (the "Proposed Rule") and we appreciate the opportunity to share our comments.

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Mercer has extensive experience designing and implementing executive and director compensation programs and assisting public companies with their executive compensation disclosures. Our Talent business services also include consulting and expertise in broad-based rewards, HR transformation, talent strategy, communication, and mobility, as well as a full range of best-in-class information and technology solutions.

Summary of Mercer recommendations

We agree with the general principle that companies should recover compensation that was earned based on misstated financials. However, we have some suggestions and requests for clarifications. Here is a summary of our recommendations:

I. Covered companies

The Proposed Rule applies to all companies that list equity or debt securities on a US stock exchange or stock market, with no exemptions for smaller reporting companies (SRCs), emerging growth companies (EGCs), or foreign private issuers (FPIs).

The final rule should exempt SRCs, EGCs, and FPIs.

II. Excess incentive-based compensation

The Proposed Rule requires companies to recover incentive-based compensation received in excess of the amount that would have been received under restated financials. Incentive-based compensation is defined as amounts granted, earned, or vested based wholly or in part on the attainment of any "financial reporting measure." Financial reporting measures are defined as financial statement, stock price, and total shareholder return (TSR) measures. Companies may use "reasonable estimates" to determine the excess when stock price and TSR measures are involved.

The final rule should:
- *Exclude amounts granted, earned, or vested based on stock price and TSR measures.*
- *Permit companies to calculate excess compensation by netting overpayments in one year with underpayments in another year.*
- *Clarify how the rule applies to "bonus pools".*

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III. Amounts received while not an executive officer

The Proposed Rule covers all individuals who served as executive officers any time during the performance period covering the incentive pay subject to clawback.

The final rule should limit recoupment to amounts an individual earned while an executive officer.

IV. Restatement trigger

Under the Proposed Rule, the three-year look-back period for recoupment is triggered by the date a company is required to prepare a financial restatement to correct material errors. Companies are required to prepare a restatement on the earlier of the date (i) the board or committee or authorized officers conclude, or reasonably should have concluded, a restatement was necessary or (ii) a court or regulator directed the company to restate its financials.

The final rule should clearly state that the requirement to prepare a restatement under the rule is evaluated using the same criteria as for a Form 8-K filing, and that "reasonably should have concluded" is intended to cover those few situations where a company may be required to file a Form 8-K but does not do so.

V. Discretion

Under the Proposed Rule, companies can choose not to claw back compensation only in two limited circumstances: (i) the direct expense of enforcement exceeds the amount to be recovered ("expense exception") and (ii) a FPI obtains an opinion from home country counsel that recoupment would violate home country laws that were adopted before July 14, 2015 ("FPI exception").

The final rule should:
- *Allow companies to reasonably estimate the cost of compliance (vs require a reasonable attempt to recover) for the expense exception.*
- *Fully exempt FPIs or, at a minimum, expand the FPI exception to cover laws adopted after July 14, 2015.*
- *Include a de minimis exception of $10,000 excess compensation per individual.*

VI. Disclosures

If during its last completed fiscal year a company prepared a restatement that required recovery of excess incentive compensation (or had not yet recovered the full balance of excess compensation

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relating to a prior restatement), detailed disclosures are triggered under new Item 402(w) of Regulation S-K. Some of these disclosures require naming individual executive officers. These disclosures must be blocktagged in XBRL. Adjustments to Summary Compensation Table (SCT) compensation are also required.

The final rule should:

- *Not require naming of individuals in SEC filings.*
- *Clarify how to report amounts recovered in the SCT and the Pay-Versus-Performance Table.*
- *Eliminate the requirement to tag filings in XBRL.*

VII. Grandfathering

Under the Proposed Rule, companies must recover excess incentive-based compensation received by executives on or after the effective date of the final SEC rule that was based on financial information for any fiscal period ending on or after the effective date. There is no grandfather for pre-existing arrangements.

The final rule should grandfather amounts received for performance periods that begin before the effective date of the listing standards.

Detailed explanation of Mercer's recommendations

I. Covered companies

The Proposed Rule applies to all companies that list equity or debt securities on a US stock exchange or stock market, with no exemptions for SRCs, EGCs, or FPIs.

The final rule should exempt SRCs, EGCs, and FPIs.

A. SRCs and EGCs

Imposing the rule on SRCs and EGCs could impede the facilitation of capital formation. SRCs and EGCs may have adequate, but less robust, internal controls than larger companies and are less likely to have already adopted a clawback policy. This would place a disproportionate burden on them to invest in upgraded internal controls and implement a compliant clawback policy. The final rule should exempt SRCs and EGCs or, at a minimum, provide for delayed implementation for a three-year period as was proposed for SRCs in the SEC's proposed Pay-Versus-Performance rule.

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B. FPIs

Foreign countries should be able to follow their home country rules as to when it is mandatory to claw back compensation. We agree with Commissioner Gallagher that "injecting U.S. corporate governance theory into foreign countries via a U.S. listing standard is an overreach." Also, FPIs generally report under International Financial Reporting Standards (IFRS) which, as the proposing release points out, sets different criteria for a restatement than US GAAP, potentially resulting in inconsistent standards for US and non-US companies.

II. Excess incentive-based compensation

The Proposed Rule requires companies to recover incentive-based compensation received in excess of the amount that would have been received under restated financials. Incentive-based compensation is defined as amounts granted, earned, or vested based wholly or in part on the attainment of any "financial reporting measure." Financial reporting measures are defined as financial statement, stock price, and TSR measures. Companies may use "reasonable estimates" to determine the excess when stock price and TSR measures are involved.

The final rule should:

- *Exclude amounts granted, earned, or vested based on stock price and TSR measures.*
- *Permit companies to calculate excess compensation by netting overpayments in one year with underpayments in another year.*
- *Clarify how the rule applies to "bonus pools".*

A. Stock price and TSR measures

We understand the SEC's rationale for including stock price and TSR measures in defining incentive-based compensation (e.g., TSR is a frequently used performance metric and excluding it could incentivize companies to alter their executive compensation programs). However, the same can be said for incentives based on service, strategic, and operational goals – which are excluded under the Proposed Rule. We believe the challenges of including stock price and TSR measures outweigh the benefits.

Calculating the appropriate amount to claw back from incentive payments based on stock price or TSR performance is significantly more difficult than calculating the clawback amount for a financial reporting measure, as the connection between financial metrics and stock price is indirect. While the difficulty is somewhat mitigated by a company's ability to use "reasonable estimates," this raises different concerns. Companies are likely to turn to third parties for these calculations, due to

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the degree of expertise required, need for an independent opinion, sensitivity of the matter, and possibility that executive officers and litigious shareholders will challenge the calculations. In fact, the SEC staff notes in the proposing release that reasonable estimates may require an "event study" by outside experts.

Using a third party could substantially add to the cost of compliance – which may be disproportionate to the amount to be recovered. A study of restatements by the Center for Audit Quality *(Financial Restatement Trends in the United States: 2003–2012)* – which was considered by the SEC in its economic analysis – showed 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 0%.

While companies may ultimately be able to rely on the expense impracticability exemption for stock price and TSR measures, they would first have to incur the costs of a study to determine how much would have to be clawed back.

B. Netting

The final rule should allow companies to calculate excess incentive-based compensation by netting incentive-based compensation overpayments with incentive-based compensation underpayments that result from restating financial statements for multiple periods during the three-year recovery period. This would put the executive in the same place he or she would have been in if the original financials had been correct, as shown in the following example:

> *Example.* A company determines in 2019 that a financial restatement for a material error in revenue recognition is required – triggering a 2016-2018 lookback period. The restatement results in shifting revenue from 2018 to 2017. As a result, an incentive payment in 2017 would have been greater under the restatement, while the incentive payment for 2018 would have been lower. The excess amount paid for 2018 performance would be clawed back, but without netting the clawback amount against the 2017 underpayment, the executive is penalized.

In our example, if netting isn't permitted and a company decides to make executives whole, it would have to make up the shortfall in 2019. Even though the additional amounts relate to 2017, it would be disclosed in the SCT as paid in 2019. This would distort the 2019 pay for performance link and could also exacerbate the effects of a clawback on the company's and individual's after-tax positions.

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C. Bonus pools

The Proposed Rule defines incentive-based compensation to include bonuses paid from a "bonus pool," the size of which is based wholly or in part on satisfying a financial reporting measure performance goal. In the event of a covered restatement, companies are to reduce the size of the aggregate pool by applying the restated financial reporting measure. If the reduced bonus pool is less than the aggregate amount of individual bonuses paid from it, shortfalls are allocated pro rata among participants based on the size of the original award. If the aggregate reduced pool would have been sufficient to cover individual bonuses, no recovery is required. We request clarification of the following:

> The compensation committee establishes a bonus pool for its executives based on the company's net income (a common incentive design to facilitate compliance with the requirements for performance-based compensation under IRC Section 162(m)). The committee also sets an individual goal for the CEO based on return on equity (ROE). At the end of the year, the compensation committee determines that the net income formula would allow for a payment to the CEO of up to $3 million, but the CEO should be paid $1 million based on achievement of the ROE goal. The company is later required to restate its financials such that the amount earned based on ROE would have been only $600,000 while the amount earned under the net income formula is unchanged. Is the CEO entitled to the full $1 million payment since he or she could have received up to $3 million under the net income formula after the restatement, or must the CEO repay $400,000?
>
> We believe the relevant financial reporting measure is net income as would be the case if the CEO's actual bonus payment was based on discretion, or a strategic or operational performance measure.

III. Amounts received while not an executive officer

The Proposed Rule covers all individuals who served as executive officers any time during the performance period covering the incentive pay subject to clawback. Executive officers are defined as in Exchange Act Rule 16a-1(f).

The final rule should limit recoupment to amounts an individual earned while an executive officer.

The Proposed Rule requires recovery of incentive-based compensation of any individual who served as an executive officer at any time during an award's performance period. We believe individuals promoted or demoted during the performance period should not be held accountable

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for events that occurred when they were not in a position of authority. This can be addressed by prorating excess compensation based on the period of time an individual was an executive officer relative to the full performance period.

IV. Restatement trigger

Under the Proposed Rule, the three-year look-back period for recoupment is triggered by the date a company is required to prepare a financial restatement to correct material errors. Companies are required to prepare a restatement on the earlier of the date (i) the board or committee or authorized officers conclude, or reasonably should have concluded, a restatement was necessary or (ii) a court or regulator directed the company to restate its financials.

The final rule should clearly state that the requirement to prepare a restatement under the rule is evaluated using the same criteria as for a Form 8-K filing, and that "reasonably should have concluded" is intended to cover those few situations where a company may be required to file a Form 8-K but does not do so.

The Proposed Rule states, in the note to paragraph (c)(2), that the timing and determination of materiality of a restatement are expected to coincide with the occurrence of the event described under Item 4.02(a) of Exchange Act Form 8-K, but are not "predicated on if or when a Form 8-K is filed." While the SEC's intent is fairly clear, we believe the "reasonably should have concluded" standard is vague. We think the standard would be clearer (and consistent with the spirit of the Proposed Rule) if the final rule clearly states (1) if a company files a Form 8-K under Item 4.02(a), the clawback rule applies and (2) if a company doesn't file a Form 8-K, the clawback doesn't apply unless the company should have filed a Form 8-K. If there are additional circumstances that could trigger a clawback, the final rule should include examples.

V. Discretion

Under the Proposed Rule, companies can choose not to claw back compensation only in two limited circumstances: (i) the direct expense of enforcement exceeds the amount to be recovered ("expense exception") and (ii) a FPI obtains an opinion from home country counsel that recoupment would violate home country laws that were adopted before July 14, 2015 ("FPI exception").

The final rule should:

- *Allow companies to reasonably estimate the cost of compliance (vs require a reasonable attempt to recover) for the expense exception.*

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- *Fully exempt FPIs or, at a minimum, expand the FPI exception to cover laws adopted after July 14, 2015.*
- *Include a de minimis exception of $10,000 excess compensation per individual.*

A. Expense exception

Under the Proposed Rule, before concluding that it would be impracticable to recover compensation based on the expense of enforcement, a company must "first make a reasonable attempt to recover that erroneously awarded compensation." As we understand, this means the company would still have to navigate the normal recovery process, including running calculations to identify the recoverable amounts, attempting to recover the amounts, and documenting the associated costs to prove the costs outweigh the amounts to be recovered. In some cases, a company will have to spend more than the amounts to be recovered just to determine it doesn't have to recover the amounts. This is particularly true when stock price and TSR measures are used as discussed above and shown in the following example (paraphrased from Commissioner Gallagher's dissent):

> *Example.* An executive received $1,000 in compensation based on achieving a TSR goal. Under the Proposed Rule, the company might have to spend thousands of dollars to hire a third party to do an event study to show that $200 of that pay was not properly earned. The company would probably need to pay lawyers to advise the board and to draft the demand letter to the executive. If the executive refuses to return the money, the board could then determine that further pursuit of the $200 was not justified based on impracticability, but only after it documents those attempts and provides the documentation to the exchange — of course, at further expense. So an issuer could spend tens or hundreds of thousands of dollars in shareholder money all before being able to determine that the cost outweighed the recoverable amount.

The final rule should allow companies to estimate the costs of recoupment without actually going through the process of attempting recovery. Companies regularly weigh the potential costs and benefits of actions during the normal course of business without undertaking the contemplated action itself. Directors have fiduciary duties to shareholders and will not make these decisions lightly and, given the disclosures that will be required, shareholders that are displeased with a decision not to claw back will have notice and opportunity to challenge the decision in court.

B. FPI impracticability exception

As discussed above, we believe FPIs should be excluded from the final rule. However, if they are included, the FPI exemption should not depend on whether home country laws were adopted

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before July 14, 2015. If it does, a subsequently adopted law could force a company to delist in the US.

C. De minimis exception

The Proposed Rule does not include a de minimis exception and, as discussed above, requires companies to undertake "reasonable efforts" to use the expense impracticability exception. This means there will be situations where the process of demonstrating "reasonable efforts" will exceed the amount that could be recovered.

We believe the final rule should include a de minimis exception of $10,000 excess compensation per individual. There is a precedent for this dollar amount: for purposes of SCT disclosure, SEC rules allow companies to exclude NEO perquisites with an aggregate value of less than $10,000.

VI. Disclosures

If during its last completed fiscal year a company prepared a restatement that required recovery of excess incentive compensation (or had not yet recovered the full balance of excess compensation relating to a prior restatement), detailed disclosures are triggered under new Item 402(w) of Regulation S-K. Some of these disclosures require naming individual executive officers. These disclosures must be blocktagged in XBRL. Adjustments to SCT compensation are also required.

The final rule should:
- *Not require naming of individuals in SEC filings.*
- *Clarify how to report amounts recovered in the SCT and the Pay-Versus-Performance Table.*
- *Eliminate the requirement to tag filings in XBRL.*

A. Naming of individuals

We agree that information on when clawback policies are triggered and how companies enforce them is important to shareholders. However, we believe naming individual executive officers in public documents is inflammatory and only serves the purpose of shaming individuals. We recommend that SEC filing disclosures be limited to:

- The date the restatement is required
- The aggregate dollar amount of excess incentive-based compensation attributable to the restatement

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- The estimates used in determining excess incentive-based compensation
- The aggregate dollar amount that remained outstanding at the end of the last completed fiscal year
- The aggregate dollar amount the company decided not to pursue recovery, number of individuals from whom the company decided not to pursue recovery, and reason the company decided not to pursue recovery
- If amounts are outstanding for more than 180 days, the aggregate amounts due at the end of the company's last completed fiscal year and the number of individuals affected.

If the stock exchanges believe individual names are critical to their analysis as to whether a company has complied with their listing standards, they could require that amounts be broken down by individual when the company submits its annual form to the exchange affirming its compliance with corporate governance listing standards.

B. Adjusting SCT amounts

Under the Proposed Rule, a new instruction to the SCT requires that any amounts recovered reduce the amount reported in the applicable column for the fiscal year in which the amount recovered initially was reported. This means the years for which amounts clawed back were initially reported won't always be reported in the SCT in which the clawback is reported.

> *Example:* In June 2017, a calendar year company determines it must restate its 2016 financial statements. Under the proposed rule, amounts earned by covered executive officers in 2014, 2015, and 2016 are subject to clawback. The next SCT will appear in the company's 2018 proxy statement and cover 2015, 2016, and 2017. The amounts clawed back for 2014 will never be reported in the SCT.

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The final rule should clarify that amounts that will never be reported in the SCT should be reported in a footnote.

The final rule should also clarify that clawed back amounts would reduce the amount reported as "compensation actually paid" in the proposed Pay-Versus-Performance Table.

C. XBRL tagging

The Proposed Rule requires disclosures to be coded and tagged in XBRL format as a separate exhibit. As Commissioner Piwowar noted in his dissent, the proposal, like the Pay-Versus-Performance proposal, "seeks to extend interactive data for proxy statements in a piece-meal fashion." We agree with Commissioner Piwowar that it would be better to have a more comprehensive approach to providing interactive data contained in the proxy statement, rather than adding individual items. We note that the Commission opted not to require XBRL tagging for pay ratio disclosures.

VII. Grandfathering

Under the Proposed Rule, companies must recover excess incentive-based compensation received by executives on or after the effective date of the final SEC rule that was based on financial information for any fiscal period ending on or after the effective date. There is no grandfather for pre-existing arrangements.

The final rule should grandfather amounts received for performance periods that begin before the effective date of the listing standards.

Many companies have legally binding contracts with executives that do not subject incentive-based compensation to clawback rights that comply with the Proposed Rule. In the proposing release, the SEC says these contracts can't serve as a basis for the expense exception, because contracts can be amended to comply with the clawback mandate. The amendment of legally binding contracts, however, could open companies up to potentially lengthy and costly renegotiation or litigation with their employees. As a condition to agreeing to a clawback, employees may demand additional consideration, disrupting a company's pay-for-performance link.

We believe, at a minimum, existing contracts should be considered a sufficient basis for the expense exception. However, we think a grandfather is more appropriate because it levels the playing field between companies that have broad clawback provisions in their existing contracts and those that don't.

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VII. Tax and other regulatory issues

The Proposed Rule does not address the potential for exposure under IRC Section 409A, ERISA, and state laws in connection with the recovery of excess incentive compensation. The SEC should consider these concerns in connection with the final rule.

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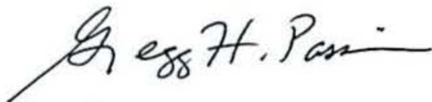
Thank you for the opportunity to comment on the Proposed Rule. Let us know if you have any questions or comments.

Regards,



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