

September 14, 2015

**Comment on *Listing Standards for Recovery of Erroneously Awarded Compensation* issued by the Securities and Exchange Committee**

Japanese Bankers Association

We, the Japanese Bankers Association (“JBA”), would like to express our gratitude for this opportunity to comment on *Listing Standards for Recovery of Erroneously Awarded Compensation* issued by the Securities and Exchange Committee (the “SEC”).

We respectfully expect that the following comments will contribute to your further discussion.

**[General Comment]**

We recognize the necessity of the proposed rule.

Uniform application of requirements on recovery of compensation to all foreign listed issuers would be extremely difficult to ensure alignment with laws and regulations of respective jurisdictions, and would force foreign listed issuers to take unfeasible actions. We therefore respectfully request the SEC to consider establishing a regulatory framework that takes into account laws and regulations in respective jurisdictions including Japan.

Additionally, to minimize regulatory cost burden, the scope of executive officers should be limited to some extent so as to avoid a significant inconsistency with other compensation requirements, while ensuring that the objective of the proposed rule is met.

Our comments on specific issues are discussed in the Specific Comments below.

**[Specific Comments] (Our response to the questions)**

Question 1

Should the listing standards and other requirements of the proposed rule and rule amendments apply generally to all listed issuers, as proposed? If not, what types of issuers should be exempted, and why? Please explain the rationale that justifies exempting any particular category of issuer.

(Our response)

Foreign private issuer should be exempted for the following reason.

Some foreign private issuers issue their financial statements in accordance with the home country accounting standard along with US GAAP-based financial statements. Financial statements that are required to comply with the U.S. listing standards are those prepared in accordance with US GAAP. The price of ADR traded in the U.S. market is generally linked to a stock price of the home country market, and hence the correlation between US GAAP based financial statements is not necessarily high. Given this, we do not support the proposed rule requirement to include compensation tied to stock price into incentive-based compensation and define an accounting restatement as a trigger for recovery of such compensation tied to stock price. Additionally, 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.

Question 3

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

(Our response)

- (1) The proposed listing standards are considered to conflict with the applicable laws in Japan, because it is an open question whether it is permitted to interpret that the applicable Japan law requires the listed issuer to recover excessive incentive compensation attributable to the restatement from an executive officer who is not willing to do so. In particular, new laws and regulations need to be developed in Japan in order for a listed issuer to force a former executive officer who has already retired and has no legal responsible to the cause of restatement to return excess incentive-based compensation regardless of his/her intention.
- (2) The reason is as follows: Under the judicially created doctrine in Japan, it is interpreted that the entire or portion of compensation may not be forced to be returned unless agreed by the director since once the amount of compensation for

the director is determined by, for example a resolution at a general shareholders' meeting or a board of directors meeting, the amount of such compensation is set forth in a contract between the listed issuer and the director, thereby binding both parties to the contract. It is therefore requested to permit foregoing erroneously awarded compensation if there is no agreement with the director.

Additionally, if a listed issuer seeks to claim recovery of already-paid compensation to an individual who is an employee to whom the Labor Standards Act and the Labor Contract Act of Japan are applied, the Labor Standards Act requires to set forth wages and other matters in the employment rules. Any change to work conditions which are unfavorable to employees need justification, and listed issuers need to make careful consideration in forcing an employee to return excessive incentive-based compensation. Further, even when such an employee assumes legal responsibility for the cause of restatement, claiming recovery of the excessive incentive-based compensation would have a risk of being filed a suit by an individual who is such an employee or sued by labor authorities, and acknowledged as violating the Labor Standards Act and/or the Labor Contract Act. It is therefore requested to permit foregoing recovery of such excessive incentive-based compensation.

- (3) An effective means would be to illustrate cases where foregoing of recovery of erroneously awarded compensation would be permitted.

#### Question 12

For purposes of proposed Rule 10D-1, an accounting restatement would be defined as the result of the process of revising previously issued financial statements to correct errors that are material to those financial statements. Rather than including this definition in our proposed rule, should we refer to the definition of "restatement" in GAAP? If we do not refer to the definition in GAAP, is it appropriate to include in the proposed definition the phrase "errors that are material" or might it be confusing or redundant? Is our proposed approach the appropriate means to implement Section 10D, including its "material noncompliance" provision?

(Our response)

Since material errors of financial statements are not clearly defined, it is requested to set certain criteria, such as quantitative criteria. If all financial restatements are subject to recovery of incentive-based compensation with no clear criteria, and the correction of

financial statements due to negligence is subject to recovery of incentive-based compensation, such treatment would rather have an adverse impact of preventing appropriate corrections.

Question 23

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

(Our response)

The scope of executive officers should be limited to those directly or indirectly involved in the restatement. The broadly defined scope of executive officers might result in requiring return of compensation to executive officers with no responsibility for restatement. Listed issuers should have primary discretion to determine the scope of executive officers subject to a compensation recovery policy. In cases of malicious window-dressing, since legal sanction is imposed through such as class action suits by shareholders, ultimately, the scope should be determined by judicial judgement of the home country. Given this, the definition of executive officers, in its nature, is not amenable to the application of “one-size-fits-all” rule under the listing rules.

Additionally, the scope of executive officers shall be defined in a manner to avoid a significant inconsistency with other compensation requirements, while ensuring that the objective of the proposed rule is met. Differing scope from other requirements (e.g., *Pillar 3 disclosure requirements for remuneration* by the Basel Committee on Banking Supervision) would require cumbersome management procedures, thereby placing an overly burden.

Question 26

Is the scope of incentive-based compensation subject to recovery under Section 10D(b) properly defined by reference to compensation that is granted, earned or vested based wholly or in part upon attainment of any measure that is determined or presented in accordance with applicable accounting principles? If not, please explain what other forms of compensation should be covered and why.

(Our response)

The definition of compensation that is tied to financial reporting measures and stock price metrics should clarify that it means compensation and stock options that are tied to

performance metrics under financial reporting.

Compensation tied to management accounting should be excluded from the scope of the proposed rule because such compensation has less relevance with performance metrics subject to disclosure.

Question 29

Should compensation that is based upon stock price performance or total shareholder return be considered incentive-based compensation subject to recovery? If not, please explain why not. If compensation that is based on stock price performance or total shareholder return is included as incentive-based compensation subject to recovery, what calculations would need to be made to determine the recoverable amount? What are the costs and technical expertise required to prepare these calculations? Who would make these calculations for issuers? Would the costs be greater than for calculations tied to other financial reporting measures, which would be subject to mathematical recalculation directly from the information in an accounting restatement? Would the exchanges be able to efficiently assess these calculations for purposes of enforcing compliance with their listing standards? Why or why not? Should we require an independent third party to assess management's calculations?

(Our response)

Compensation that is based upon stock price performance or total shareholder return should be excluded from the scope of recovery.

Financial statements are not only the determinant of stock prices because these are also affected by factors such as market movements and demands and supply. Further, a restatement of financial statements is not limited to cases where net income is overstated, but also includes cases where net income is understated or a correction relates to footnote disclosures. The impact of a restatement of financial statements on the stock price is extremely difficult to calculate, and the recovery amount, by nature, should not be determined in a uniformed manner under the listed standards.

Question 37

- (1) Should a different approach be used to determine the three-year look-back period for recovery?
- (2) If so, how should the look-back period be determined, and why? For example, should an issuer be permitted to apply its recovery policy to any three-year period in which incentive-based compensation received by executive officers was affected by the accounting error?

(Our response)

- (1) We do not object to setting a three-year look-back period. It is however requested to clarify (2) below.
- (2) This three-year look-back period should be limited to the period after a listed issuer has developed the recovery policy. Since however the treatment of setting such look-back period is not clearly defined, it is requested to clarify that this three-year look-back period is not applicable to the preceding three-year period before developing the recovery policy. Specifically, the listing standards should specify that the recovery period of erroneously-paid incentive compensation be the period “after the day on which the listed issuer has adopted the recovery policy” after exchanges and other bodies in the U.S. have implemented the amended listing standards.

Question 44

For incentive-based compensation based on stock price or total shareholder return, would permitting the recoverable amount to be determined based on a reasonable estimate of the effect of the accounting restatement, as proposed, facilitate administration of the rule by issuers and exchanges? Why or why not? Should we provide additional guidance regarding how such estimates should be calculated? If so, what particular factors should that guidance address?

(Our response)

Compensation that is based upon stock price performance or total shareholder return should be excluded from the scope of recovery.

Financial statements are not only the determinant of stock prices because these are also affected by factors such as market movements and demands and supply. Further, a restatement of financial statements is not limited to cases where net income is overstated, but also includes cases where net income is understated or a correction to footnote disclosures. The impact of a restatement of financial statements on the stock

price is extremely difficult to calculate, and the recovery amount, by nature, should not be determined in a uniformed manner under the listed standards.

Question 59

How and under what circumstances, if any, should the board of directors be able to exercise discretion regarding the amount to be recovered? What steps should the board of directors be required to take, if any, before exercising any permitted discretion about the amount to be recovered from individual executive officers?

(Our response)

It is requested to provide a specific example for the approach to recover stock options. Since the real value of stock options awarded as a compensation fluctuates in response to the stock price at the time of exercising the option, if a trigger event to recover compensation has occurred, it is practically very difficult to measure prices or determine the design of the recovery method.

Question 60

- (1) Are there any material tax considerations relevant to whether an issuer should be able to exercise discretion as to the amount of recovery?
- (2) If so, please explain.

(Our response)

(1)

- (I) The approach for the tax treatment (such as the treatment of personal income tax when returning compensation) should be clearly provided for. In particular, the treatment of tax when a recipient of compensation has already paid the personal income tax after receiving compensation from the listed issuer is not clear (whether the tax paid will be refunded).
- (II) With respect to a tax consideration, it is requested to define the amount of erroneously awarded compensation as the net-of-tax amount.

(2)

- (I) If consistency of tax regime is not achieved across jurisdictions, the proposed rule would give rise to un-level playing field, and may create a considerable confusion in practice.
- (II) Under current practice of payments of salary and executive officer compensation in Japan, the listed issuer will withheld (deduct) the amount of personal income

and municipal taxes, and the net-of-tax amount will be paid to the receiving account of an executive officer. If, in a subsequent year, the executive officer returns compensation received, the executive officer himself or herself needs to claim for tax refund to a competent tax authority where he or she had resided at the time of payment of personal income and municipal taxes. Such refund may not be made, or even if made, may take a considerable time. As a result, the executive officer is forced to make a payment on behalf of the listed issuer for the time lag discussed above, including the non-refunded tax amount. Given this, it is not considered appropriate since such requirement would impose unduly burden on executive officers.

Question 76

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

(Our response)

The disclosure of the names of executive officers from whom recovery has been forgone should be avoided, by for example, limiting the disclosure to those directors with a final responsibility of preparing and disclosing financial statements (such as an officer at a position equivalent to CEO or an officer responsible for preparing financial statements). This disclosure is closely related to the treatment of the personal information protection act of respective jurisdictions. In the case of Japan, for example, the scope of separate disclosure for financial reporting purposes is limited to a recipient of compensation exceeding JPY0.1billion. Consequently, a uniformed disclosure requirement would cause a difficulty in achieving alignment with laws and regulations of respective jurisdictions. Therefore, it is considered that such requirement prompts an action which is unfeasible for listed issuers, and hence should be reconsidered.



Question 102 (General Request for Comment)

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

(Our response)

- (1) The proposed SEC rule provides violation of home country law as an exceptional case for permitting the listed issuer to forgo recovery of erroneously paid compensation.

On the other hand, the proposed SEC rule requires listed issuers to disclose the aggregate dollar amount of excess incentive-based compensation attributable to accounting restatement, the excess incentive-based compensation that had been outstanding for 180 days or longer, and the name of each person from whom the listed issuer decided not to pursue recovery, and a brief description of the reason of such decision.

Requiring the listed issuer to disclose the name of an executive officer from whom the listed issuer decided not to pursue recovery based on the exceptions set out would result in indirectly forcing the recovery of compensation and thus considered to be inappropriate. Therefore, for those cases set out in the proposed rule as exceptions to compensation recovery, it is requested to permit non-disclosure of the names of applicable executive officers.

- (2) The proposed rule sets forth that exchanges should give effect to their listing rules no later than one year following the day on which the finally adopted version is published in the Federal Register, and that each listed issuer should adopt the recovery policy no later than 60 days following the date on which the exchanges' rules become effective. Consequently, there is a concern that lead time may become very short. SEC and/or exchanges in the U.S. should give consideration to ensure sufficient lead time, in particular, for foreign listed issuers which need to carefully consider potential violations of the home country law. More specifically, for the period in which the foreign private issuers create their recovery policy, it is requested to ensure at least one year following the date on which the amended exchanges' rules are published.
- (3) Foreign private issuers such as Japanese banks are preparing their financial statements in accordance with their home country standard as well as US GAAP or

IFRS. In such a case, performance-based compensation would be based on the home country accounting standard. We would like to confirm whether the disclosure required under the proposed rule should also be applicable to such case.

If such disclosure is required, it is requested to specify in the rule that foreign private issuers should only refer to their home country standard for the restatement standard, and also provide specific disclosure methods. The proposed rule is developed assuming that individual issuers only apply a single set of accounting standards. Whereas some Japanese banks prepare financial statements under double accounting standards, and performance-based compensation is based on the home-country standard. In practice, for 20-F disclosure purposes, listed issuers disclose claw-back information based on financial statements which are not presented in the financial information section of 20-F (that is, financial statements prepared under the home-country standard). Consequently, in the absence of clear disclosure guidance, there is a concern that the comparability may be undermined.