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## IS THE SEC CLAWBACK RULE UNLAWFUL?

*Nasdaq and NYSE-listed companies must have a compensation recovery policy that complies with the Securities and Exchange Commission's clawback rule. The rule requires the clawback of executive compensation after an accounting restatement due to material noncompliance with financial reporting requirements. But the clawback rule exceeds its statutory authorization. The rule mandates clawbacks even after immaterial error corrections and even from non-executive officers. The statute authorizes neither of those types of clawbacks. The rule is unlawful. The SEC should revise the rule to comport with its statutory authority or a court should vacate the rule.*

By Joel H. Trotter \*

Every company listed on Nasdaq or the NYSE must have adopted a clawback policy that complies with the listing standards mandated by the Securities and Exchange Commission. Under the SEC's mandate, contained in Rule 10D-1, every listed company's clawback policy must require recovery of executive compensation after an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws.

Congress authorized a clawback rule that establishes specific prerequisites for a compensation clawback. But the SEC rule, effective in December 2023, requires clawbacks under circumstances that do not satisfy the statutory prerequisites. Instead, Rule 10D-1 mandates compensation clawbacks under circumstances that exceed Congress's statutory authorization and conflict with the unambiguous statutory text.

In particular, the authorizing statute conditions clawbacks on an issuer's material noncompliance with a financial reporting requirement. In contrast, the SEC's rule requires a clawback after an immaterial error correction that involves no publicly reported material error and therefore no material noncompliance with any financial reporting requirement. The SEC's own

calculations indicate that this excess alone broadened the rule's scope by more than four times the scope that Congress authorized. The SEC's rule also broadens the scope of mandatory clawbacks to include a category of persons that the statutory text does not cover.

As a result, the SEC's clawback rule is unlawful. The SEC should revise the rule to comply with Congress's statutory authorization. Otherwise, a court should hold the rule unlawful and set it aside.

### I. CONGRESS AUTHORIZED A MUCH NARROWER RULE THAN THE ONE THE SEC ADOPTED

#### A. The Clawback Rule Congress Authorized

Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (adding Section 10D to the Securities Exchange Act of 1934) mandated SEC rule-making to direct the national securities exchanges to prohibit the listing of any issuer that does not maintain an executive compensation clawback policy that satisfies Section 10D's requirements.

Section 10D authorizes a mandatory clawback policy that requires a listed issuer to recover incentive-based

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compensation paid to any executive officer in the prior three years if:

- “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” and
- the executive officer received compensation “based on the erroneous data, in excess of what would have been paid to the executive officer under the accounting restatement.”<sup>1</sup>

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<sup>1</sup> SEC. 954. RECOVERY OF ERRONEOUSLY AWARDED COMPENSATION. The Securities Exchange Act of 1934 is amended by inserting after section 10C, as added by section 952, the following:

“SEC. 10D. RECOVERY OF ERRONEOUSLY AWARDED COMPENSATION POLICY.

“(a) LISTING STANDARDS.—The Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that does not comply with the requirements of this section.

“(b) RECOVERY OF FUNDS.—The rules of the Commission under subsection (a) shall require each issuer to develop and implement a policy providing —

“(1) 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; and

“(2) that, 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 issuer will recover from any current or former executive officer of the issuer who received incentive-based compensation (including stock options awarded as compensation) during the three-year period preceding the date on which the issuer is required to prepare an accounting restatement, based on the erroneous data, in excess of what would have been paid to the executive officer under the accounting restatement” (emphasis added).

## ***B. The Clawback Rule the SEC Adopted***

### ***1. SEC Rule 10D-1***

The SEC implemented Section 10D’s rule-making mandate in October 2022 by adopting Exchange Act Rule 10D-1, which prescribes the elements of the mandatory clawback policy and requires the national securities exchanges to implement the clawback mandate through their listing standards.<sup>2</sup> In response, NYSE and Nasdaq implemented new listing standards requiring listed companies to adopt compliant clawback policies.<sup>3</sup>

### ***2. Comparing the Statute and the Rule***

Rule 10D-1 expands the circumstances for compensation clawbacks beyond Congress’s statutory authorization. Section 10D requires as a prerequisite for a compensation clawback:

“an accounting restatement due to the *material noncompliance* of the issuer with any financial *reporting* requirement under the securities laws.”<sup>4</sup>

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<sup>2</sup> Listing Standards for Recovery of Erroneously Awarded Compensation, Release No. 33-11126 (Oct. 26, 2022) [hereinafter “Adopting Release”], available at <https://www.sec.gov/rules/final/2022/33-11126.pdf>.

<sup>3</sup> On March 7, 2023, the NYSE and Nasdaq proposed listing standards in accordance with Rule 10D-1. On June 9, 2023, the SEC approved the exchanges’ proposed clawback listing standards effective October 2, 2023, giving companies 60 days to comply with the new standards. As a result, the NYSE and Nasdaq required listed companies to adopt Rule 10D-1 compliant clawback policies by December 1, 2023.

<sup>4</sup> Section 10D; see also Report of the Senate Committee on Banking, Housing, and Urban Affairs, S. 3217, Report No. 111-176 at 135 (Apr. 30, 2010) [hereinafter “Senate Report”] (“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.”) (emphasis

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By contrast, Rule 10D-1 requires listed issuers to claw back compensation even after the correction of only *immaterial* financial statement errors — *without* the occurrence of *any* “material noncompliance of the issuer with any financial reporting requirement under the securities laws.”

In particular, Rule 10D-1 requires listed issuers to:

“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 [1] to correct an error in previously issued financial statements that is material to the previously issued financial statements *or* [2] *that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period.*”<sup>5</sup>

### C. Clarifying the Rule’s Two Types of Error Corrections

Thus, Rule 10D-1 includes two different error-correction scenarios as independent predicates for a clawback event — namely, any correction of a financial statement error:

[1] that is material to the previously issued financial statements (known as a “Big R restatement”);<sup>6</sup> or

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added); Adopting Release, *supra* note 2, at 6 (“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.”) (emphasis added).

<sup>5</sup> Rule 10D-1(b).

<sup>6</sup> A “Big R restatement” — When the error is material to the prior period(s) financial statements, the error is corrected through a “Big R restatement.” The error also may be material to current period financial statements but that fact is not determinative in assessing whether a “Big R restatement” is appropriate. A “Big R restatement” corrects all material errors including the

[2] that *would* result in a material misstatement *if* the error were corrected in the current period *or* left uncorrected in the current period (known as a “little r restatement”).<sup>7</sup>

The latter of these two circumstances expands the predicates for clawbacks beyond the scope of Congress’s statutory authorization. The distinction between Big R and little r scenarios makes this apparent.

### D. Understanding the Rule’s Second Type of Error Correction

The SEC’s Chief Accountant has explained the distinction between an error correction known as a Big R

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correction of material errors relating to classification and disclosure. A “Big R restatement” requires an entity to revise previously issued financial statements (e.g., via a Form 10-K/A filing or in some cases the next Form 10-K filing) to reflect the correction of the error in those financial statements. When an entity concludes a “Big R restatement” is appropriate, the prior financial statements cannot be relied upon and therefore the entity must notify users of the financial statements that those financial statements can no longer be relied upon. Ernst & Young LLP, “Accounting Changes and Error Corrections” (April 2024) at 75 [hereinafter “EY Guide”], *available at* <https://perma.cc/34L9-7CXL>.

<sup>7</sup> A “Little r restatement” — In some cases, an error is immaterial to the prior period(s) financial statements; however, correcting the error in the current period would materially misstate the current period financial statements (i.e., the turn-around effect of the error correction is material to the current period income statement or statement of comprehensive income). This situation often occurs when an immaterial error remains uncorrected for multiple periods and aggregates to a material number. Because correcting the error in the current year would materially misstate those financial statements, the prior period(s) financial statements should be corrected, even though such revision previously was and continues to be immaterial to the prior period(s) financial statements. However, correcting prior period(s) financial statements for immaterial errors would not require previous filings to be amended (e.g., no Form 10-K/A required). Such correction may be made the next time the registrant files the prior period(s) financial statements. This type of “Little r restatement” provides for correcting the error in the current period financial statements by adjusting the prior period information and adding disclosure of the error. Because the prior period financial statements were not materially misstated, the entity is not required to notify users that they can no longer rely on the prior financial statements and the auditor’s opinion is not modified when the prior period information is next presented. *Id.* at 76 (footnote omitted).

restatement and an error correction colloquially known as a little r restatement:

“When an error is determined to be material to previously issued financial statements, the error must be corrected by restating the prior-period financial statements. This type of restatement is sometimes referred to colloquially as a reissuance restatement or a ‘Big R’ restatement.

“If the error is not material to previously issued financial statements, but either correcting the error or leaving the error uncorrected *would be* material to the *current* period financial statements, a registrant must still correct the error, but is not precluded from doing so in the current period comparative financial statements by restating the prior period information and disclosing the error. This type of restatement is sometimes referred to colloquially as a revision restatement or a ‘little r’ restatement.”<sup>8</sup>

The distinction between the Big R and little r scenarios hinges on whether prior-period financial statements contain a material error.<sup>9</sup> The flowchart in the appendix illustrates how they differ.

The difference between the Big R and little r error-correction scenarios carries important implications for Rule 10D-1. These implications are discussed in the next section.

## II. THE RULE EXCEEDS THE STATUTE BY INCLUDING LITTLE R RESTATEMENTS AS A CLAWBACK PREDICATE

Two related conclusions follow from the distinction between Big R and little r restatements. First, Section 10D requires a Big R restatement as a predicate for a mandatory clawback under the statute, whereas a little r restatement fails to satisfy the statutory predicate. Second, Rule 10D-1 exceeds the scope of the

congressional authorization in Section 10D by mandating clawbacks based on a little r restatement.

The Big R restatement scenario satisfies the statutory authorization because the correction of a material error in previously issued financial statements fulfills Section 10D’s statutory clawback prerequisite of “an accounting restatement due to the *material noncompliance* of the issuer with any financial reporting requirement under the securities laws.”

Unlike a Big R restatement, however, a little r restatement involves correcting an error that is immaterial to all previously issued financial statements — thereby stopping a would-be material error *before* it gets publicly reported in the current period — resulting in immaterial error corrections to prior periods and *no* instance of material noncompliance with any financial reporting requirement. In addition, unlike a Big R restatement, a little r restatement does not constitute an “accounting restatement” for purposes of Section 10D.

### ***A. Little r Restatements Involve No “Material Noncompliance” with a “Reporting Requirement”***

The historical errors corrected in a little r restatement are *immaterial in all respects* and therefore do not satisfy Section 10D’s required predicate of “an accounting restatement due to the *material noncompliance* of the issuer with any financial *reporting* requirement under the securities laws.”

The SEC considered the concern that a little r restatement does not involve “material noncompliance of the issuer with financial reporting requirements” but rejected that observation, concluding that “both types of restatements” satisfy the statutory requirement:

“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. 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

<sup>8</sup> Statement of Paul Munter, Acting Chief Accountant, “Assessing Materiality: Focusing on the Reasonable Investor When Evaluating Errors” (Mar. 9, 2022), *available at* <https://www.sec.gov/news/statement/munter-statement-assessing-materiality-030922>.

<sup>9</sup> KPMG, “Accounting Changes and Error Corrections” (Nov. 2024) at 7 [hereinafter “KPMG Guide”], *available at* <https://perma.cc/S2FW-RWN7>.

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.”<sup>10</sup>

Contrary to the SEC’s stated reasoning, a little r restatement does not involve “material noncompliance with any financial reporting requirement under the securities laws,” as Section 10D requires.

First, the SEC claims that a little r restatement involves material noncompliance resulting 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.” But that entails zero noncompliance. Neither of those events occur in the case of a little r restatement: the error is neither left uncorrected nor is the correction recorded only in the current period. Instead, the current-period material error is a hypothetical one that is never publicly reported — and hence never results in “*material noncompliance* of the issuer with any financial reporting requirement

under the securities laws” — precisely because the accumulated current-period error is corrected, or reduced to an immaterial level, by correcting prior-period immaterial errors through the little r restatement.

Second, the SEC argues that a little r restatement satisfies the statutory clawback predicate because “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.” But, in fact, the plain language of Section 10D requires “an accounting restatement due to the *material noncompliance* of the issuer with any *financial reporting requirement* under the securities laws.” And, in every little r restatement, no error correction implicates any material noncompliance with any financial reporting requirement under the securities laws because all of the *reported* financial information remains materially correct both before and after the little r restatement. Section 10D cannot extend to material noncompliance that never materializes.

### ***B. The Term “Accounting Restatement” in Section 10D Does Not Include a Little r Scenario***

The term “accounting restatement” in Section 10D does not include a little r error-correction scenario, which necessarily involves only the correction of immaterial prior-period errors, because generally accepted accounting principles (“GAAP”) by their terms do not apply to immaterial items.

The SEC considered the concern that a little r restatement does not satisfy the meaning under Section 10D of an “*accounting restatement*” but rejected that observation, concluding incorrectly that a little r restatement satisfies the accounting definition of a “restatement”:

“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 International Financial Reporting Standards (“IFRS”) because both result in revisions of previously issued financial

<sup>10</sup> Adopting Release, *supra* note 2, at 33-34. The SEC describes this scenario as an example, taken from Staff Accounting Bulletin No. 108, of a little r restatement: “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.” *Id.* at 34 & n.106; *see also* Staff Accounting Bulletin No. 108, Question 2 (Sept. 13, 2006), available at <https://www.sec.gov/oca/staff-accounting-bulletin-108>.

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statements for a correction of an error in those financial statements.”<sup>11</sup>

Contrary to the SEC’s stated reasoning, the correction of immaterial errors that occurs in a little r restatement does not satisfy the Section 10D prerequisite of an “accounting restatement” under GAAP or IFRS requirements, which apply only to material items. A little r restatement is therefore not an “accounting restatement” that an “issuer is required to prepare” within the meaning of Section 10D.

First, the Director of the SEC’s Division of Corporation Finance in 2015 emphasized this point when the SEC first proposed Rule 10D-1. Discussing “the definition of an ‘accounting restatement’ for purposes of the proposed rule,” the then-Director “confirmed that the proposal *extends only to so-called ‘Big R’ restatements*, meaning restatements to correct material errors in the financial statements.”<sup>12</sup> The Director explained: “There is no intention here to create new restatement definitions that deviate from GAAP concepts associated with restatement under ASC 250.”<sup>13</sup>

Second, although GAAP defines a restatement as “the process of revising previously issued financial statements to reflect the correction of an error in those financial statements,”<sup>14</sup> an immaterial error correction does not constitute a “restatement” within the meaning of ASC 250, *Accounting Changes and Error Corrections*, because “[t]he provisions of the [FASB Accounting Standards] Codification need not be applied to immaterial items.”<sup>15</sup> In the context of a Big R

restatement, involving material error corrections, “the column headings in the financial statements should include ‘As Restated’” to indicate the material error corrections.<sup>16</sup> By contrast, in the context of a little r restatement, involving only immaterial error corrections, “the financial statement columns should *not* be labeled ‘as restated’” and “revising prior year financial statements would *not* require previously issued auditor reports to be corrected as users can continue to rely on those previously issued financial statements.”<sup>17</sup> Reissued financial statements in a Big R restatement must be labeled “Restated” — hence the “Big R” — whereas revised financial statements in the process colloquially called a little r restatement should *not* bear the “Big R” label.

The SEC failed to acknowledge this key distinction or its derivation from the *express statement* in GAAP that its provisions “need *not* be applied to *immaterial* items.”<sup>18</sup> The SEC also failed to acknowledge that the same fundamental principle appears in SEC Staff Accounting Bulletin No. 99 on Materiality, which the Staff published to “provide guidance to financial management and independent auditors with respect to the evaluation of the materiality of misstatements that are identified in the audit process or preparation of the financial statements.”<sup>19</sup> SAB 99 begins its discussion of materiality by reciting the all-encompassing premise that GAAP pronouncements apply only to material, and not to immaterial, items: “Each Statement of Financial Accounting Standards adopted by the [FASB] states,

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<sup>11</sup> Adopting Release, *supra* note 2, at 33.

<sup>12</sup> Keith F. Higgins, “Highlights of the Dialogue with the Director of the SEC’s Division of Corporation Finance,” Meeting of the Federal Regulation of Securities Committee of the ABA Business Law Section (Sept. 18, 2015) at 11, *available at* <https://perma.cc/MZ6U-JJP5>.

<sup>13</sup> *Id.*

<sup>14</sup> Adopting Release, *supra* note 2, at 26 n.72 (quoting FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections*).

<sup>15</sup> FASB Accounting Standards Codification Topic 105, *Generally Accepted Accounting Principles*, 105-10-05-6. The same principle applies under International Financial Reporting Standards as issued by the International Accounting Standards Board. See International Accounting Standard 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, paragraph 8 (noting that IFRS policies “*need not be applied* when the effect of applying them is *immaterial*”).

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<sup>16</sup> KPMG Guide, *supra* note 9, at 107 (“The SEC staff has stated that when there is a correction of a material error, the column headings in the financial statements should include ‘As Restated.’”); EY Guide, *supra* note 6, at 83 (“For ‘Big R restatements,’ entities should label the prior period column headings of applicable financial statements and related footnote disclosures ‘As restated.’”).

<sup>17</sup> PwC, “Financial Statement Presentation” (Aug. 2024) § 30.7.2, at 30-16, *available at* <https://perma.cc/U87R-CKRC>; *see also* EY Guide, *supra* note 83 (explaining that, for a little r restatement, “the error is corrected in the current-period financial statements by adjusting the prior-period information” and “prior period column headings are not generally labeled as restated given the prior year adjustment is, by definition, immaterial”).

<sup>18</sup> Accounting Standards Codification Topic 105, *Generally Accepted Accounting Principles*, ASC 105-10-05-6 (“The provisions of the [FASB Accounting Standards] Codification need not be applied to immaterial items.”).

<sup>19</sup> Staff Accounting Bulletin No. 99 (Aug. 12, 1999) at n.1, *available at* <https://www.sec.gov/interp/account/sab99.htm>.



‘The provisions of this Statement need *not* be applied to immaterial items.’”<sup>20</sup> Big R restatements involve the correction of a material error under ASC 250 and application of the “Restated” label, whereas little r restatements involve immaterial error corrections to which ASC 250 does not apply. Only a Big R restatement involves presenting financial statements under the “Restated” rubric, whereas a little r restatement is a colloquial term that describes an error correction process outside of the ASC 250 requirements under GAAP.

### **C. The Rule’s Overbreadth Far Exceeds the Statutory Authorization**

The SEC has expanded Rule 10D-1’s reach far beyond Section 10D’s statutory authorization by including little r restatements as a mandatory clawback predicate. The SEC’s own calculations indicate that this has *expanded by over 420%* the number of scenarios that will become predicates for a mandatory compensation clawback.<sup>21</sup>

### **III. THE RULE EXCEEDS THE STATUTE BY INCLUDING PERSONS EXCLUDED FROM SECTION 10D**

Finally, Rule 10D-1 also exceeds its statutory authorization by requiring compensation recovery for a broader group of persons than “executive officers” as defined under the Exchange Act. Section 10D

contemplates a mandatory clawback policy that applies only to “any current or former executive officer of the issuer.” In contrast, Rule 10D-1 uses its own, broader definition of “executive officer” that ignores the general Exchange Act definition and instead tracks the definition of “officer” under Section 16, which includes the principal accounting officer (or, if there is no such accounting officer, the controller) even if that person is not an executive officer under the Exchange Act.<sup>22</sup>

As a result, Rule 10D-1 requires the mandatory clawback policy to apply to persons who are not executive officers under the Exchange Act even though Section 10D authorizes a mandatory clawback only from “any current or former executive officer.” Congress intended the clawback policy mandate to apply only to the “very limited” category of “executive officers,” and it “is not required to apply to other employees.”<sup>23</sup>

### **IV. RULE 10D-1 VIOLATES THE APA**

As a result of these defects, Rule 10D-1 violates the Administrative Procedure Act. The APA requires a reviewing court to “hold unlawful and set aside agency action” that is “not in accordance with law” or “in excess of statutory jurisdiction.”<sup>24</sup> The statute “makes clear that agency interpretations of statutes — like agency interpretations of the Constitution — are *not* entitled to deference.”<sup>25</sup> Instead, under the APA, it “remains the responsibility of the court to decide whether the law means what the agency says.”<sup>26</sup>

<sup>20</sup> *Id.*; see also Scott Taub, “Defining a Material Issue,” Compliance Week (Nov. 24, 2015) (“Prior to the ASC’s creation in 2009, every standard issued by the Financial Accounting Standards Board ended with boxed reminder, ‘The provisions of this statement need not be applied to immaterial items.’ So that little sentence, in slightly different form, has been around for more than 40 years.”), available at <https://www.complianceweek.com/defining-a-material-issue/11485.article>.

<sup>21</sup> Memorandum, SEC Division of Economic and Risk Analysis (June 8, 2022) at 3-4 (indicating that, in 2021, Big R restatements represented less than one-fourth of the 227 total Big R and little r restatements combined and acknowledging, with conspicuous understatement, that a 420% expansion of Rule 10D-1’s scope “would increase the total number of restatements that could potentially trigger a compensation recovery analysis”); see also *id.* at 3 & n.18 (indicating that, in 2020, the number of Big R restatements represented less than one-fourth of total Big R and little r restatements combined), available at <https://www.sec.gov/comments/s7-12-15/s71215-20130560-298718.pdf>.

<sup>22</sup> Compare Exchange Act Rule 3b-7 (defining “executive officer” under the Exchange Act) with Rule 16a-1(f) (defining “officer” under Section 16 to include not only persons in the executive officer definition but also the principal accounting officer (or, if there is no such accounting officer, the controller) even if that person is not an executive officer under Rule 3b-7); see also Rule 10D-1(d) (defining “executive officer” to correspond to the definition of “officer” under Rule 16b-1(f) rather than the existing Exchange Act definition of “executive officer” under Rule 3b-7).

<sup>23</sup> Senate Report, *supra* note 4, 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”) (emphasis added).

<sup>24</sup> 5 U.S.C. § 706.

<sup>25</sup> *Loper Bright Enters. v. Raimondo*, 603 U.S. 369, 392 (2024) (overruling *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)).

<sup>26</sup> *Id.* (quoting *Perez v. Mortgage Bankers Assn.*, 575 U.S. 92, 109 (2015) (Scalia, J., concurring in judgment)).

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Rule 10D-1 is therefore not entitled to agency deference. And the meaning of the statutory phrase “material noncompliance of the issuer with any financial reporting requirement under the securities laws” presents no ambiguity as applied to a little r restatement or to an “officer” who is not an “executive officer.”

Moreover, even if an ambiguity were present, Rule 10D-1 exceeds the scope of Section 10D and is not the best reading of the statute. When faced with a statutory ambiguity, a reviewing court must “determine the best reading of the statute and resolve the ambiguity,” recognizing that “statutes, no matter how impenetrable, do — in fact, must — have a single, best

meaning” that “‘is fixed at the time of enactment.’”<sup>27</sup> As a result, by adopting Rule 10D-1, which requires compensation clawbacks for immaterial errors, the SEC has not “acted within its statutory authority, as the APA requires.”<sup>28</sup>

## CONCLUSION

Rule 10D-1 is unlawful. The SEC should amend it to bring the rule within the statutory authorization of Section 10D. Otherwise, a court should “hold unlawful and set aside” Rule 10D-1 as an agency action that is “not in accordance with law” and “in excess of statutory jurisdiction.”<sup>29</sup> ■

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<sup>27</sup> *Id.* at 400 (quoting *Wisconsin Central Ltd. v. United States*, 585 U. S. 274, 284 (2018)).

<sup>28</sup> *Id.* at 412; *see also Business Roundtable v. SEC*, 647 F.3d 1144, 1156 (D.C. Cir. 2011); *Fin. Planning Ass’n v. SEC*, 482 F.3d 481, 493 (D.C. Cir. 2007); *Goldstein v. SEC*, 451 F.3d 873, 883-84 (D.C. Cir. 2006); *Chamber of Com. v. SEC*, 443 F.3d 890, 908 (D.C. Cir. 2006); *Am. Bankers Ass’n v. SEC*, 804 F.2d 739, 755-56 (D.C. Cir. 1986).

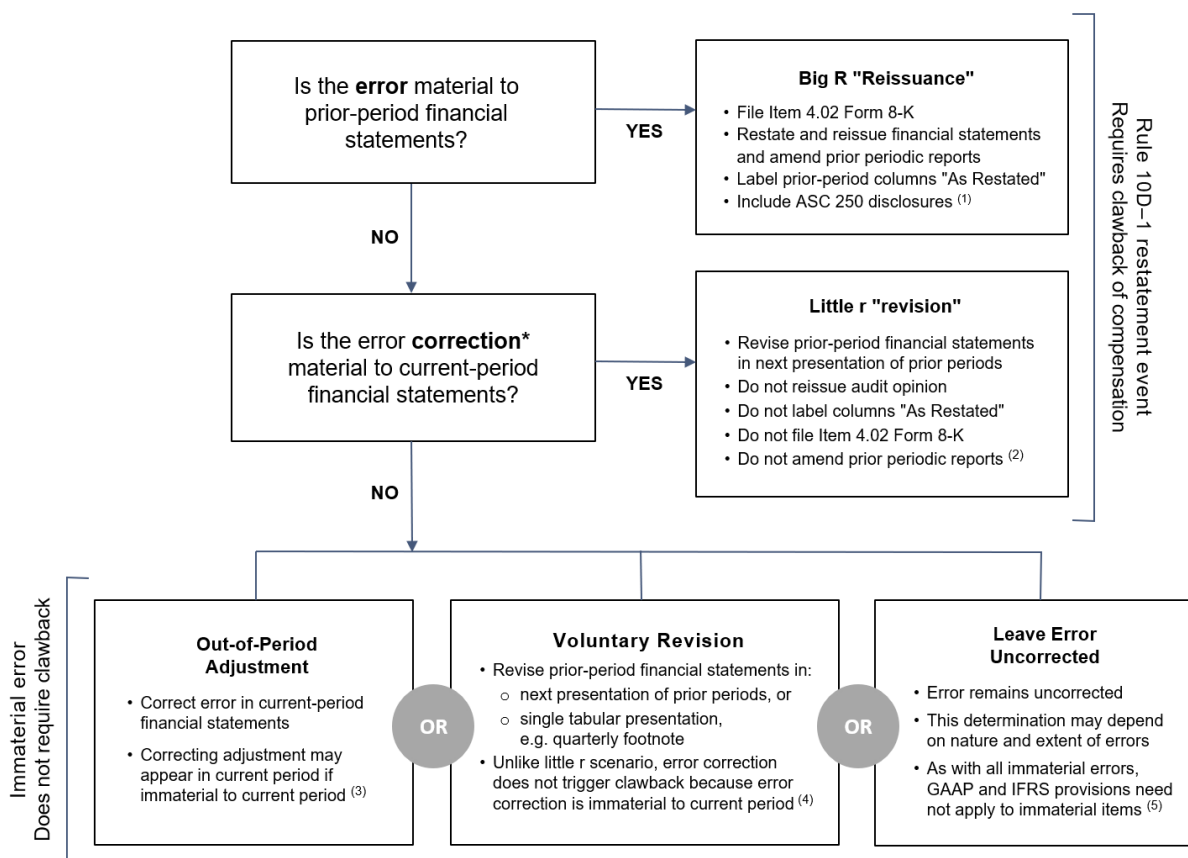
<sup>29</sup> 5 U.S.C. § 706.



## APPENDIX

### The Overbreadth of Rule 10D-1

Rule 10D-1 defines “accounting restatement” with unprecedented breadth, capturing not only the traditional understanding of an ASC 250 restatement “to correct an error in previously issued financial statements that is material to the previously issued financial statements” (i.e., a Big R Reissuance) but also a type of immaterial error correction process for an unreported error “that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period” (i.e., a little r revision). As shown in this flowchart, only the Big R scenario satisfies the statutory predicate of “an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws.” The little r scenario does not.



\* Rule 10D-1(b)(1) incorrectly treats a little r revision as a clawback predicate even though all financial reporting remains materially correct both before and after the little r revision. The correction avoids a current-period material misstatement.

- (1) ASC 250-10-50-7 governs the correction of a material error in prior-period financial statements, with reissued financial statements labeled “Restated” — hence the “Big R” — unlike a little r revision.
- (2) In a little r revision scenario, revised financial statements are not labeled “Restated,” the auditor does not reissue its financial statement audit opinion, and no material noncompliance with any financial reporting requirement occurs.
- (3) An out-of-period adjustment is possible only if the adjustment is immaterial to current-period financial statements.
- (4) Voluntary revisions are similar to little r revisions but are not required to avoid a current-period material misstatement.
- (5) Immaterial errors require no correction. *See* ASC 105-10-05-6 (US GAAP provisions “need not be applied to immaterial items”); *see also* IAS 8, ¶ 8 (IFRS policies “need not be applied when the effect of applying them is immaterial”).