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"More on Clawbacks: Action Items and Implementation Considerations"

Thursday, November 16, 2023

Course Materials

"**More on Clawbacks: Action Items and Implementation Considerations**"

Thursday, November 16, 2023

2:00 - 3:00 pm Eastern [archive and transcript to follow]

At our 20th Annual Executive Compensation Conference, one thing was crystal clear from the "Clawbacks: Key Action Items Now" panel: there are tons of complex decisions and open interpretive issues that unlucky companies faced with a restatement will need to tackle in order to implement their Dodd-Frank clawback policy, once adopted. Our experienced panelists addressed many of these in an engaging and interactive dialogue at the conference and have graciously agreed to continue the conversation about the myriad of implementation and disclosure issues causing companies and their advisors to lose sleep.

Joining us are:

- **Mark Borges**, Principal, Compensia and Editor, CompensationStandards.com
- **Renata J. Ferrari**, Partner, Ropes & Gray
- **Ronald O. Mueller**, Partner, Gibson Dunn
- **Kyoko Takahashi Lin**, Partner, Davis Polk

This program will cover:

- Process if Restatement Occurs
    - What Incentives Are Affected
    - Process/Tips for Calculating (and Documenting) Impact
    - Practical Mechanics for Recovery (Including Exceptions)
    - Impact on Restatement-Related Disclosure Requirements
    - Complicating Factors from Incentive Plan or Employment Agreement Design (e.g., TSR/stock price, plan pools, scorecards with multiple metrics and partial discretion, good reason definitions)
- Do You Need to Amend Other Policies, Provisions, Programs, or Disclosures?
    - Common Areas of Overlap/Potential Conflict — and How to Resolve
    - Responding to SEC & DOJ Enforcement Initiatives & Programs
- Finalizing and Maintaining Your Policy
    - Confirming Your Policy is Ready for Prime Time (that is, filing as a 10-K exhibit)
    - What To Do if You Need to Amend
    - How to Review and How Often

"**More on Clawbacks: Action Items and Implementation Considerations**"

Course Outline/Notes

1. Process if Restatement Occurs
    a. What Incentives Are Affected
    b. Process/Tips for Calculating (and Documenting) Impact
    c. Practical Mechanics for Recover (Including Exceptions)
    d. Impact on Restatement-Related Disclosure Requirements
    e. Complicating Factors from Incentive Plan or Employment Agreement Design (e.g., TSR/stock price, plan pools, scorecards with multiple metrics and partial discretion, good reason definitions)

2. Do You Need to Amend Other Policies, Provisions, Programs, or Disclosures?
    a. Common Areas of Overlap/Potential Conflict — and How to Resolve
    b. Responding to SEC & DOJ Enforcement Initiatives & Programs

3. Finalizing and Maintaining Your Policy
    a. Confirming Your Policy is Ready for Prime Time (that is, filing as a 10-K exhibit)
    b. What To Do if You Need to Amend
    c. How to Review and How Often

More on Clawbacks: Action Items and Implementation Considerations

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SEC Adopts Compensation Recovery ("Clawback") Policy and Disclosure Rules

On August 26, 2022, the SEC adopted final rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act requiring the Commission and the national securities exchanges to prohibit the listing of companies that do not adopt, disclose, and enforce a compensation recovery ("clawback") policy that applies to incentive-based compensation provided to their current and former executive officers. This action completes the SEC's rule-making under the Dodd-Frank Act, a process which began over 12 years ago with the enactment of the Act.

This Thoughtful Pay Alert summarizes the key aspects of the final rules and provides our initial observations about the likely impact of this new disclosure and corporate governance requirement on technology and life sciences companies.

Four Things Technology and Life Sciences Companies Should Know about the SEC's Final Rules on the New Clawback Requirement

- **General Requirement:** Companies listed on a national securities exchange will have 60 days from the date the SEC approves the applicable listing standard to adopt a compliant clawback policy
- **Policy Features:** The clawback policy will be required to:

- Apply to current and former executive officers (essentially, Section 16 officers)
- Apply to any accounting restatement resulting from a material error – misconduct not required
- Apply to incentive compensation (including performance-based stock options) if earned based on attainment of financial reporting measures
- Does not apply to base salaries, bonuses paid solely upon satisfying one or more subjective standards and/or completion of a specified employment period, or equity awards where vesting is contingent solely upon completion of a specified employment period
- Recover excess compensation received during the three completed fiscal years preceding the date that the restatement is required

- **Required Disclosure:** Listed companies will be required to file their clawback policy with their Form 10-K and disclose the details about the recovery of any excess compensation in their proxy statement
- **Implementation and Effective Date:** Compliance with the final rules will involve a multi-step process:

- The final rule will become effective 60 days after publication in the Federal Register (which is expected to occur later this month)
- The national securities exchanges will have 90 days from the date of such publication to submit a proposed listing standard to the SEC for approval and one year from the date of such publication to have the listing standard approved
- Listed companies will have 60 days from the date the SEC approves the new listing standard to adopt a compliant clawback policy
- **Thus, each listed company will likely need to have a compliant clawback policy in place before the end of 2023**
- **We recommend that technology and life sciences companies contact their legal counsel to review their current clawback policies and begin thinking about whether they will need to amend their existing policy or adopt a new policy to meet the anticipated listing standard requirements**

Background

To enhance the oversight of executive compensation programs, Section 954 of the Dodd-Frank Act added new Section 10D to the Securities Exchange Act of 1934. Section 10D requires the SEC to direct the national securities exchanges to prohibit the listing of any company that has not developed and adopted a policy providing that:

- if the company is required to prepare an accounting restatement due to noncompliance with any financial reporting requirement under the securities laws,
- the company will recover from any of its current or former executive officers
- who received incentive-based compensation (including performance-based stock options) during the three-year period preceding the date the company is required to prepare the accounting restatement based on the erroneous data

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- the amount in excess of what would have been paid to the executive officer under the accounting restatement.

On July 1, 2015, the SEC proposed rules to begin the implementation of Section 10D. However, no further action was taken for the next six years. In October 2021 and again in June 2022, the SEC reopened the comment period on the proposed rules to solicit input on a series of questions about possible changes to the proposed rules, including the expansion of the type of financial restatements that would trigger a compensation recovery analysis

Clawback Policy Requirement

Rather than leave the substantive rulemaking to the national securities exchanges, the final rules set forth the specific terms of the required clawback policy that must be contained in the exchanges' listing standards. Generally, the clawback policy must provide that, in the event a company is required to prepare an accounting restatement due to its material non-compliance with any financial reporting requirement under the federal securities laws, the company will reasonably promptly recover (on a pre-tax basis) the amount of incentive-based compensation received by its current or former executive officers in excess of the amount of incentive-based compensation that would have been received had such compensation been determined based on the restated amount.

Executives Subject to Clawback Policy

The clawback policy must apply to a listed company's current and former "executive officers," who are defined to include its president, principal financial officer, principal accounting officer (or if there is none, the controller), any vice-president in charge of a principal business unit, division, or function (such as sales administration or finance), any other officer who performs a policy-making function, and any other person who performs similar policy-making functions for the company. In addition, executive officers of the company's parent or subsidiaries would be deemed executive officers of the company if they perform such policy making functions for the company.

The clawback policy will only require recovery of incentive-based compensation received by an individual after beginning service as an executive officer and if that individual served as an executive officer at any time during the recovery period.

Observations. The required listing standard will define the term "executive officer" in a manner modeled after the definition of the term "officer" as used for purposes of Section 16 of the Exchange Act. Further, the clawback policy will apply to any individual who served as an executive officer and received incentive-based compensation at any time during the three-year period preceding the date of the financial restatement. However, in a change from the proposed rules, this will not include incentive-based compensation derived from an award authorized before the individual became an executive officer.

Since the clawback policy is to be applied broadly – and without regard to individual "fault" or "misconduct," a potentially large number of individuals will be subject to the policy, possibly reshaping how a compensation committee considers the design and mix of the compensation arrangements for its executive officers. This could involve the use of more non-financial performance measures in incentive-based compensation plans and/or the re-weighting of the mix of equity awards between performance-based and time-based awards. In addition, listed companies will need to develop a means for tracking former employees who served as an executive officer and received incentive-based compensation to be able to enforce their clawback policy in the event of a subsequent financial restatement.

Accounting Restatement Trigger

In a significant change from the proposed rules, the clawback policy must provide for recovery of erroneously awarded compensation in the event a company is required to prepare an accounting restatement due to its material non-compliance with any financial reporting requirement under the federal securities laws, including a required accounting restatement:

- to correct an error in previously issued financial statements that is material to such financial statements (a so-called "Big R" restatement); or

- to correct an error in previously issued financial statements that is not material to such financial statements, but which would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period (a so-called "little r" restatement).

Observations. The expansion of the definition of the type of accounting restatements that will trigger a clawback analysis likely increases the number of accounting restatements that will need to be scrutinized to determine whether recovery of incentive-based compensation will be required. While not all of these "little r" restatements will result in triggering a company's clawback policy, it is clear that some will, thereby requiring companies to consider the possible application of their clawback policy any time an error in previously issued financial statements is flagged

Further, unlike similar policies (such as the compensation recovery required by Section 304 of the Sarbanes-Oxley Act), the required clawback will be triggered on a "no fault" basis – that is, the sole trigger for a clawback will be an accounting restatement. Recovery will not be based on the finding of any misconduct or even an executive officer being found responsible for the accounting error leading to the financial statement.

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Three-Year Recovery Period

The clawback policy must apply to all excess incentive-based compensation received during the three completed fiscal years preceding the date upon which a listed company is required to prepare an accounting restatement. This date is to be the earlier to occur of the date:

- the board of directors, a committee of the board, or the officer or officers authorized to take such action if board action is not required, concludes, or reasonably should have concluded, that its previously issued financial statements contain an error; or
- a court, regulator or other legally authorized body directs the company to restate its previously issued financial statements to correct a material error.

The required listing standard will also specify how the three-year "look-back" period is to be measured, providing that this period comprise the three completed fiscal years immediately preceding the date a company is required to complete an accounting restatement. For example, if a company with a calendar year fiscal year concludes in November 2023 that a restatement of previously issued financial statements is required and files the restated financial statements in January 2024, the clawback policy will apply to incentive-based compensation received in 2020, 2021, and 2022.

Finally, the required listing standard will provide that incentive-based compensation is to be deemed "received" in the fiscal period during which the financial reporting measure specified in the incentive-based compensation is attained, even if the payment or grant of the incentive-based compensation occurs after the end of that period. In addition, an award that is subject to a financial reporting measure and a service-based vesting condition (such as a performance-based equity award with a time-based vesting "tail") is considered received when the financial reporting measure is achieved, even if the award continues to be subject to the time-based vesting condition.

Observations. In the case of a listed company's decision to conduct a restatement, the date of this decision will be determined objectively; that is, the appropriate date for measuring the three-year "look-back" period will be the date when a reasonable company, based on the facts available, would have concluded that the previously issued financial statements contained an error. Generally, it is expected that this date will coincide with the date upon which the company is obligated to file a current form on Form 8-K notifying investors that its previously issued financial statements may no longer be relied upon.

Compensation Subject to Recovery

The clawback policy will apply to any "incentive-based compensation," defined as "any compensation that is granted, earned, or vested based wholly or in part upon the attainment of any financial reporting measure." This definition encompasses both cash and equity, including stock options and other equity awards whose grant or vesting is based, in whole or in part, upon the attainment of any measure based upon or derived from financial reporting measures.

For purposes of the required listing standard, a "financial reporting measure" will be defined as:

- any measure that is determined and presented in accordance with the accounting principles used in preparing the company's financial statements;
- any measure derived, in whole or in part, from such financial information;
- stock price; and
- total shareholder return ("TSR").

The inclusion of "stock price" as a financial reporting measure will introduce several challenges in determining excess incentive-based compensation because of the complexities involved in determining the impact of accounting errors on stock price movement. In recognition of these potential issues, the required listing standard permits companies to use reasonable estimates to assess the effect of an accounting restatement on stock price and TSR and require that these estimates be disclosed.

Observations. Based on this definition, compensation subject to the clawback policy will include (but not be limited to):

- non-equity incentive plan awards that are earned based, in whole or in part, on satisfying a financial reporting measure performance goal;
- bonuses paid from a "bonus pool," the size of which is determined based, in whole or in part, on satisfying a financial reporting measure performance goal;
- other cash awards based on satisfaction of a financial reporting measure performance goal;
- restricted stock, restricted stock units, performance share units, stock options, and stock appreciation rights that are granted or become vested based, in whole or in part, on satisfying a financial reporting measure performance goal;
- proceeds received upon the sale of shares acquired through an incentive plan that were granted or vested based, in whole or in part, on satisfying a financial reporting measure performance goal.

For most technology and life sciences companies, the clawback policy will apply to restricted stock or restricted stock unit ("RSU") awards with vesting based on financial performance, RSU awards with vesting tied to relative TSR performance,

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and RSU awards with vesting tied to the achievement of future stock price goals.

Compensation that will not be considered "incentive-based compensation" will include:

- annual base salary;
- bonuses paid solely at the discretion of the board of directors or compensation committee that are not paid from a "bonus pool" that is determined by satisfying a financial reporting measure performance goal;
- bonuses paid solely upon satisfying one or more subjective standards (such as demonstrated leadership) and/or completion of a specified employment period;
- non-equity incentive plan awards earned solely upon satisfying one or more strategic measures (such as consummating a merger or divestiture), or operational measures (such as opening a specified number of stores, completion of a project, increase in market share);
- equity awards for which the grant is not contingent upon achieving any financial reporting measure performance goal and vesting is contingent solely upon completion of a specified employment period and/or attaining one or more nonfinancial reporting measures (such as strategic measures or operational measures; and
- compensation paid solely on a discretionary basis.

Determination of Excess Compensation

The clawback policy must require that recoverable compensation is to be calculated as "the amount of incentive-based compensation received by the executive officer . . . that exceeds the amount of incentive-based compensation that otherwise would have been received had it been determined based on the accounting restatement." Applying this approach, following an accounting restatement a listed company will:

- recalculate the applicable financial reporting measure and the amount of incentive-based compensation based thereon; and
- then determine whether, based on that financial reporting measure as calculated relying on the original financial statements and taking into account any discretion that the compensation committee had applied to reduce the amount originally received, the executive officer received a greater amount of incentive-based compensation than would have been received applying the recalculated financial reporting measure.

The recoverable compensation is to be calculated on a pre-tax basis.

For incentive-based compensation based on stock price or TSR, where the amount of excess compensation is not subject to mathematical recalculation directly from the information in an accounting restatement, the recoverable amount may be determined based on a reasonable estimate of the effect of the accounting restatement on the applicable measure. For these measures, the company will be required to maintain documentation of the determination of that reasonable estimate and provide such documentation to the relevant exchange.

Consistent with the statute, the required listing standard will provide that recovery of any excess incentive-based compensation is to be mandatory. Nonetheless, recovery will be considered "impracticable" and, thus, not be required if:

- the direct costs of enforcing recovery would exceed the recoverable amount;
- recovery would violate the company's home country law; or
- recovery would likely cause an otherwise tax-qualified retirement plan, under which benefits are broadly available to employees of the company, to fail to meet applicable federal income tax laws and the regulations thereunder.

Before relying on the first exception, a company will first need to make a reasonable attempt to recover that incentive-based compensation. In addition, the company will be required to document its attempts to recover, provide that documentation to its exchange, and disclose in its proxy statement why it determined not to pursue recovery. Similarly, before concluding that it would be impracticable to recover the compensation because doing so would violate home country law, the company first will need to obtain an opinion of home country counsel that recovery would result in such a violation.

Observations. While the determination of recoverable compensation to cash awards is likely, in most instances, to be fairly straightforward, the determination for equity awards will involve different, and potentially more challenging, considerations. As the SEC notes, in the case of equity awards:

- if the shares, stock options, or SARs are held at the time of recovery, the recoverable amount will be the number of shares received in excess of the number that should have been received applying the restated financial reporting measure;
- if the stock options or SARs have been exercised and the underlying shares are still held, the recoverable amount will be the number of shares underlying the excess options or SARs applying the restated financial reporting measures; and

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- if the shares have been sold, the recoverable amount will be the sale proceeds received with respect to the excess number of shares (less any exercise price paid to purchase the shares).

The complexity of these computations will be compounded where the relevant financial reporting measure is based on stock price or TSR. As previously noted, the challenges inherent in estimating the effect of a financial restatement on stock price will likely necessitate that most companies incur the cost and uncertainties of undertaking an analysis requiring significant technical expertise and specialized knowledge. We would not be surprised to see these challenges taken into consideration when designing an incentive compensation program and, as a practical matter, when assessing the feasibility of seeking recovery of excess incentive-based compensation from executive officers.

Filing and Disclosure Requirements

In addition to adopting and enforcing a compliant clawback policy, each listed company will be required to do the following:

- file its clawback policy as an exhibit to its annual report on Form 10-K;
- add checkboxes to the cover page of its annual report on Form 10-K, one to indicate whether the financial statements included in the report reflect the correction of an error to previously issued financial statements and one to indicate whether any of the error corrections require a recovery analysis under the company's clawback policy; and
- disclose in its proxy statement how they have applied their clawback policy if, at any time during the last completed fiscal year, either:
  - a financial restatement that triggered the clawback policy was completed; or
  - there was an outstanding balance of excess incentive-based compensation from the application of the policy to a prior restatement.

Content of Required Disclosure

Where a listed company completes the financial restatement that triggered the clawback policy, it will be required to disclose the following details about the pending recovery:

- the date on which the company was required to prepare the restatement;
- the aggregate dollar amount of excess incentive-based compensation attributable to the restatement (including an analysis of how the recoverable amount was calculated);
- if the incentive-based compensation was determined based on a stock price or TSR-related financial reporting measure, the estimates used to determine the excess incentive-based compensation attributable to the restatement (and an explanation of the methodology used to calculate such estimates);
- the aggregate dollar amount of such excess incentive-based compensation that remains outstanding at the end of its last completed fiscal year;
- if the aggregate dollar amount of erroneously awarded compensation has not yet been determined, disclose this fact, disclose the reasons, and include the previous information in the next filing required to include Item 402 compensation information
- if recovery would be impracticable, for each current and former named executive officer and for all other current and former executive officers as a group, disclose the amount of recovery and forgone and a brief description of the reason the company decided not to pursue recovery; and
- for each current or former named executive officer, the amounts of incentive-based compensation that are subject to clawback that are still outstanding for more than 180 days since the date the company determined the recoverable amount.

Location of Required Disclosure

Since the clawback policy must apply to all executive officers, not just named executive officers, this information is part of a separate disclosure requirement, and not part of the Compensation Discussion and Analysis. The SEC has noted, however, that inclusion in the CD&A will be permitted as part the listed company's compensation recovery policy disclosure.

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SEC Adopts New Rules for "Pay Versus Performance" Disclosure Requirement (Continued)

Impact on Subsequent Summary Compensation Table Disclosure

To the extent that excess incentive-based compensation is recovered, the amount subsequently reported in the Summary Compensation Table for the fiscal year in which the amount recovered initially was reported (if subject to disclosure), is to be reduced by the recovered amount, and be identified as subject to clawback by footnote.

Disclosure to be Provided in Interactive Form

Companies will be required to tag the new disclosure of any specific data points included within the clawback disclosures, as well as block text tagging of those disclosures, in an interactive data format using Inline eXtensible Business Reporting Language ("XBRL").

Other Aspects of Proposed Rules

Companies Subject to Listing Standard

The required listing standard will apply to any company listed on a national securities exchange, including smaller reporting companies, emerging growth companies, foreign private issuers, and controlled companies. Only registered investment companies will be exempt from the requirement.

Securities Subject to Clawback Policy

The required listing standard will apply to all of a listed company's listed securities, including common equity securities, debt securities, and preferred securities. Only security futures products, standardized options, and the securities of certain registered investment companies will be exempt from the requirement.

Indemnification and Insurance

The required listing standard will prohibit a listed company from indemnifying any current or former executive officer against the loss of excess incentive-based compensation. Further, while an executive officer may be able to purchase an insurance policy to fund potential recovery obligations, a listed company will also be prohibited from paying or reimbursing the executive officer for premiums for such a policy.

Consequences of Non-Compliance

Noncompliance with the applicable listing standard, the SEC's disclosure rules, or a company's own compensation recovery policy will subject the company to delisting.

Concurrent Application with Section 304 of the Sarbanes-Oxley Act

Given the overlapping scope of the two provisions, there may be circumstances in which both the required listing standard and Section 304 of the Sarbanes-Oxley Act could apply to the same incentive-based compensation. The SEC notes that the required listing standards will not alter or otherwise affect decisions under Section 304 as to when reimbursement is required. Thus, if an executive officer makes reimbursement under Section 304, this amount should be credited to the extent that a clawback policy requires repayment of the same compensation. Further, recovery under a clawback policy will not preclude recovery under Section 304 to the extent any applicable amounts have not been repaid to the listed company.

Transition and Effective Date

The final rules require the national securities exchanges to:

- submit their proposed listing standards to the SEC within 90 days of the date that the final rules are published in the Federal Register, and
- have their listing standards become effective no later than one year after the date that the final rules are published in the Federal Register.

Thereafter, each listed company will have 60 days from the date the applicable listing standard becomes effective to adopt a compliant clawback policy.

The required clawback policy must apply to any incentive-based compensation that is received by a current or former executive officer on or after the effective date of the applicable listing standard, even if the compensation was received pursuant to an award granted before adoption of the required clawback policy.

Need Assistance?

Compensia has extensive experience in helping companies understand how the corporate governance and executive compensation-related disclosure provisions of the Dodd-Frank Act will affect the design, operation, and disclosure of their executive compensation program. If you would like assistance in analyzing how the final rules are likely to impact your executive compensation program and disclosure, or if you have any questions on the subjects addressed in this Thoughtful Pay Alert, please feel free to contact Mark A. Borges.

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SEC Adopts New Rules for "Pay Versus Performance" Disclosure Requirement (Continued)

About Compensia

Compensia, Inc. is a management consulting firm that provides executive compensation advisory services to Compensation Committees and senior management.

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June 12, 2023

SEC Approves NYSE and Nasdaq Listing Standards for Compensation Clawbacks; Compliance Deadline Extended until December 1, 2023

On June 9, 2023, the Securities and Exchange Commission ("SEC") approved new listing standards that were proposed by the New York Stock Exchange ("NYSE") and Nasdaq. The new listing standards require listed companies to adopt and comply with a written policy providing for the recovery, in the event of a required accounting restatement, of incentive-based compensation received by current or former executive officers where that compensation is based on erroneously reported financial information (a "Recovery Policy"). The listing standards will take effect on October 2, 2023 (the "Effective Date") and companies will have until December 1, 2023 (60 days after the Effective Date) to adopt their Recovery Policies. The Recovery Policies must, however, apply to erroneously awarded incentive-based compensation received (as defined in the listing standards) after the Effective Date.

Mandated by a rule adopted by the SEC in October 2022 ("Rule 10D-1"), the NYSE and Nasdaq listing standards apply to most listed companies, including emerging growth companies, smaller reporting companies, and foreign private issuers (with certain limited exemptions). The standards conform to Rule 10D-1 (which is summarized in our October 27, 2022 Alert) by requiring companies to adopt and comply with a Recovery Policy that provides that the company will recover reasonably promptly the amount of erroneously awarded incentive-based compensation in the event that it is required to prepare an accounting restatement due to the company's material noncompliance with any financial reporting requirement under the securities laws, including any required accounting restatement to correct an error in previously issued financial statements that is material to the previously issued financial statements, or that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period.

Additionally, listed companies must file their Recovery Policies as exhibits to their annual reports; indicate by check boxes on their annual reports whether the financial statements included in the filings reflect correction of an error to previously issued financial statements and whether any of those error corrections are restatements that required a recovery analysis; and disclose any actions they have taken pursuant to such Recovery Policies.

Companies that do not comply with these listing standards (which include the corresponding notice-and-cure procedures) will be subject to immediate suspension and delisting of their securities from the exchanges.

The SEC's approval comes just days after the NYSE and Nasdaq amended the proposals they originally submitted to the SEC at the end of February (see our March 6, 2023 Alert). While the NYSE and Nasdaq amendments both extend the Effective Date to October 2, 2023, the NYSE amendment also modifies its suspension and delisting procedures for a noncompliance other than the delayed adoption of a Recovery Policy. While the original NYSE proposal established a cure period in the event of a listed company's failure to adopt a Recovery Policy within the required time period, it did not establish cure periods for other incidents of noncompliance with the new listing standards. Under the amended standards, the cure period and other suspension and delisting provisions that apply to the delayed adoption of Recovery Policies will now apply to all other incidents of noncompliance with the new listing standards.

Key Takeaways

Prior to the amendments last week, NYSE and Nasdaq's clawback listing standards were originally drafted to take effect upon the SEC's approval (which would have meant a compliance deadline of early August for companies). While this extension may come as welcome news, if boards and compensation committees of listed companies have not already taken steps to revise and update their existing Recovery Policies or to adopt new standalone Recovery Policies to comply with the listing standards, they should be doing so in the near term. Moreover, they should familiarize all responsible parties at the company who may have a role to play in the event of a restatement and clawback scenario (such as

employees in HR and total rewards, as well as those in finance and accounting), and finally, all Section 16 executive officers to whom the Recovery Policy will apply with the new requirements.

* * *

If you would like to follow up regarding any of the matters covered by this Alert, please contact your usual Ropes & Gray attorney.

This alert should not be construed as legal advice or a legal opinion on any specific facts or circumstances. This alert is not intended to create, and receipt of it does not constitute, a lawyer-client relationship. The contents are intended for general informational purposes only, and you are urged to consult your attorney concerning any particular situation and any specific legal question you may have. © 2023 Ropes & Gray LLP

October 27, 2022

SEC Adopts Rules on Clawback of Executive Compensation

On October 26, 2022, the Securities and Exchange Commission (the "SEC"), implementing a requirement of the Dodd-Frank Act, adopted final rules on the recovery of erroneously awarded incentive-based executive compensation – that is, incentive-based compensation awarded based on a misstated financial performance measure (including stock price and total shareholder return).

The rules primarily require:

- national securities exchanges to establish listing standards that would require listed issuers to adopt and comply with a policy for the recovery of such erroneously awarded compensation (commonly known as a "clawback policy"); and

- listed issuers to disclose information about such policy and their compliance.

The rules apply to most listed issuers, including those that are "emerging growth companies," "smaller reporting companies" and "foreign private issuers," with exemptions only for the listing of certain security futures products, standardized options, securities issued by unit investment trusts and securities issued by certain registered investment companies.

An issuer would be subject to delisting if it does not adopt and comply with a clawback policy that is compliant with its exchange's listing standards.

Effective Dates

The rules will become effective 60 days after publication in the Federal Register, and a national securities exchange's listing standard must be effective no later than one year after the effective date of the rules. An issuer subject to the listing standards must adopt its clawback policy, which must apply to all incentive-based compensation received by executive officers on or after the effective date of the applicable listing standard, no later than 60 days after the effective date of the applicable listing standard and must comply with the disclosure requirements of the rules following the date that the issuer's clawback policy is adopted.

Compensation Recovery and Disclosure Requirements

Under the new rule, an issuer that is required to prepare an accounting restatement, including a "little r restatement" (i.e., a restatement to correct an immaterial error to prior period financial statements that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period), would be required to recover from any current or former executive officers the incentive-based compensation that was erroneously awarded to such person during the three fiscal years preceding the date such restatement was required (as well as any transition period resulting from a change in the issuer's fiscal year within or immediately following those three completed fiscal years). For purposes of this rule, the date that a restatement is required is the date that the issuer's board (or a committee of the board or authorized officers) concludes, or reasonably should have concluded, that the issuer is required to prepare a restatement or, if earlier, the date that a court, regulator or other authorized body directs the issuer to prepare a restatement. In addition, the rule makes clear that an issuer's obligation to recover excess incentive-based erroneously awarded compensation is not dependent on if or when the restated financial statements are filed. The "erroneously awarded" amount is the excess of the compensation received over the amount that would have been received based on the restated amounts (computed without regard to any taxes paid). The requirement to recover such compensation is, however, subject to limited impracticability exceptions.

The definition of "executive officer" for purposes of this rule tracks the definition of "officer" found in Rule 16a-1(f) under the Securities Exchange Act and includes the issuer's president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function as well as any officer who performs a policy-making function (including executive officers of the issuer's parent(s) or subsidiaries who perform such policy making functions for the issuer).

Recovery of erroneously awarded compensation is required under the new rule regardless of any misconduct by an executive officer in connection with the error that triggers the restatement. In addition, the new rule prohibits issuers from indemnifying their current or former executive officers against the loss of erroneously awarded compensation.

A listed issuer will be required to file its clawback policy as an exhibit to its annual report and to disclose certain information about compliance with its policy, including:

- the aggregate amount of erroneously awarded compensation related to an accounting restatement, including an analysis of how the amount was calculated (using estimates, with the methodology disclosed, for awards based on stock price or total shareholder return);
- the aggregate amount of such erroneously awarded compensation yet to be recovered (or, if such amounts have not yet been determined, the reason therefor);
- the amount due from each current or former named executive officer that remains unrecovered for 180 days or more since the date the issuer determined the amount of such person's erroneously awarded compensation; and
- details about any reliance on impracticability exceptions and the amount of any such erroneously awarded compensation that will not be recovered.

Issuers will be required to use Inline XBRL to tag their compensation recovery disclosure.

Relatedly, the SEC adopted amendments to the cover pages of the annual reports on Form 10-K, Form 20-F and Form 40-F to add check boxes that indicate (a) whether the financial statements of the registrant included in the filing reflect correction of an error to previously issued financial statements and (b) whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period under the new rule.

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June 9, 2023

NYSE AND NASDAQ ALLOW MORE TIME FOR COMPANIES TO ADOPT RULE 10D-1 CLAWBACK POLICIES: WHAT TO DO NOW

To Our Clients and Friends:

This week, both the New York Stock Exchange ("NYSE") and The Nasdaq Stock Market ("Nasdaq", and together with NYSE, the "Exchanges") filed amendments with the Securities and Exchange Commission ("SEC") to provide a delayed effective date for the Exchanges' proposed listing standards requiring listed companies to adopt clawback policies, as mandated by Rule 10D-1 under the Securities and Exchange Act of 1934. Specifically, the Exchanges are proposing that their new listing standards become effective on October 2, 2023. If the listing standards are approved by the SEC, companies will have **until December 1, 2023** (60 days after the effective date) to adopt clawback policies satisfying the new listing standards ("Rule 10D-1 policies"), and the policies would need to apply to any incentive compensation "received" (as defined in Rule 10D-1) on or after October 2, 2023. The NYSE's amended proposal is available here, Nasdaq's is available here, and our client alert on the SEC's adoption of Rule 10D-1 is available here.

The delayed effective dates, which were highly anticipated, align with the SEC's statement when it adopted Rule 10D-1 in October 2022 that it anticipated companies would have "more than a year from the date the final rules are published in the Federal Register to prepare and adopt compliant recovery policies." On June 9, the SEC approved the Exchanges' proposed listing standards, as modified by these amendments to include the October 2, 2023 effective date, on an accelerated basis. The delayed effective dates will ensure that companies have adequate time to draft, customize, and implement Rule 10D-1 policies. When doing so, companies should consider the following issues:

What form should the policy take, and should it be integrated with any existing clawback policy?

The Exchanges' listing standards will require that companies adopt a written policy. Companies that have existing clawback policies need to determine whether to adopt a stand-alone Rule 10D-1 compliant policy, or whether to integrate that policy with their existing clawback policy. When faced with the prospect of an early effective date for the Exchanges' listing standards, some companies were leaning toward adoption of a stand-alone policy, but either approach is acceptable, and with more time to draft and review a compliant policy, we expect both approaches to be common. Factors to consider when making that decision include whether the existing policy applies in contexts other than financial restatements and whether the existing policy covers employees who are not "executive officers" as defined in Rule 10D-1, as well as more nuanced considerations such as how the look-back applies, how recoverable amounts are calculated, and what compensation is covered by the policy. Even if adopting a stand-alone Rule 10D-1 policy, companies should evaluate whether and, if so, how any existing policy will be amended to conform with provisions of the Rule 10D-1 policy, including any transition

provisions to apply the existing policy to compensation received prior to the effective date of the Rule 10D-1 policy. Some companies may wish to reconsider the format of their policies, particularly if the current policies are embedded in corporate governance guidelines or other documents, and should consider whether they intend to voluntarily file any other clawback policy with the SEC when they are required to file their Rule 10D-1 policy as an exhibit to their annual reports (as discussed below).

Who needs to approve the policy?

Neither of the Exchanges specify what corporate actions need to be taken or by whom to adopt a Rule 10D-1 policy. For many companies, the authority will rest with the Board's compensation committee, either through express language in the committee's charter or through a more general allocation of responsibility to the committee for oversight of executive compensation matters. However, some companies may determine that the matter is better handled by a different board committee or, after a review of applicable committee charter language, may determine that the full Board should approve or ratify approval of the Rule 10D-1 policy. Companies may also wish to consider their historic practice when addressing similar situations, such as when companies adopted hedging policies to address the disclosure requirements of Regulation S-K Item 407(i).

How is the policy enforced?

The Exchanges' listing standards will require that companies not only adopt Rule 10D-1 policies, but also comply with those policies. Companies could face delisting, as well as other possible legal exposure, if they do not recover incentive compensation on a reasonably prompt basis as provided for under their Rule 10D-1 policies. Accordingly, companies need to consider how they will enforce their policies if and when required. We expect that companies will rely on terms in incentive compensation plans, terms in award agreements under those plans, and/or stand-alone undertakings in which executives agree to be bound by and comply with a company's clawback policies. Regardless of the context, greater specificity and explicit written acceptance/signatures by covered executives may enhance enforceability. At the same time, given the breadth of arrangements to which Rule 10D-1 policies could apply (Rule 10D-1 defines "incentive-based compensation" as "any compensation that is granted, earned, or vested based wholly or in part upon the attainment of a financial reporting measure" as that term is defined in Rule 10D-1), it could be helpful for provisions that will be relied upon to enforce the Rule 10D-1 policy to apply broadly to any compensation arrangement subject to Rule 10D-1. Because the Rule 10D-1 policy needs to apply to any "incentive-based compensation" that is "received" on or after October 2, 2023, with the definition of "received" generally referring to when the applicable financial reporting measure is attained, a Rule 10D-1 policy typically will apply to incentive awards that were granted prior to October 2. Thus, express executive acknowledgements that the Rule 10D-1 policy applies to past grants also may be helpful. Some companies may also seek to document that compensation can be recovered from any amounts that might otherwise be or become due to a current or former executive, including through offsets of amounts due under non-qualified deferred compensation arrangements.

How is the policy implemented?

As noted above, Rule 10D-1 policies will apply broadly to "incentive-based compensation" that is based in whole or in part on a "financial reporting measure," which itself is broadly defined to include measures determined or derived wholly or in part from accounting measures or that are based on stock price or total shareholder return. Under Rule 10D-1 and the Exchanges' listing standards, if a company experiences a restatement that triggers the applicability of the company's Rule 10D-1 policy, the company will be required to document certain determinations and provide such documentation to the applicable Exchange. Companies should therefore carefully survey all compensation arrangements in which executive officers participate to determine which are based on a "financial reporting measure." It will be helpful in administering Rule 10D-1 policies for companies to clearly document the extent to which their executive compensation arrangements do or do not involve a financial reporting measure and, going forward, to clearly document the extent to which financial reporting measures impact the compensation committee's determinations regarding the form or amount of compensation granted, earned, vested, or otherwise provided to executive officers.

Does adoption of the policy trigger any disclosure?

Companies will be required to file their Rule 10D-1 policies as an exhibit to their Form 10-K. Compliance with the disclosure requirements is required in the first annual report required to be filed after October 2, 2023, the effective date of the new listing standards, although the SEC stated also that it would not expect compliance with the disclosure requirement until companies are required to have adopted a policy under the applicable Exchange listing standard. Companies should carefully evaluate whether adoption of a Rule 10D-1 policy, or any amendments to existing incentive compensation plans or agreements that implement the policy, constitute material new compensation arrangements or material amendments or modifications that must be disclosed. However, we believe that in most cases those actions will not trigger a Form 8-K filing under Item 5.02(e), due to both the fact that the actions relate to a contingent potential adjustment to amounts payable under existing executive compensation arrangements, and the fact that a Rule 10D-1 policy operates essentially as just an extension of the time over which the evaluation of performance measures is applied. Additional Form 10-K check-box and proxy statement disclosure requirements also apply if a company experiences a restatement during the year, as discussed in our prior client alert, so companies should establish appropriate disclosure controls to allow them to satisfy these disclosure obligations.

The following Gibson Dunn lawyers assisted in the preparation of this alert: Stephen Fackler, Krista Hanvey, Ronald Mueller, Christina Andersen, and Geoff Walter.

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DOJ announces new clawback, messaging and monitorship guidance, national security resources

March 7, 2023 | Client Update | 13-minute read

Last week, DOJ announced much-anticipated guidance on compensation clawbacks and the use of messaging apps, as well as modifications to its monitorship policies. The guidance provides companies facing a criminal resolution a roadmap to secure credit for clawbacks against fines imposed by DOJ and supplements existing guidance on financial compensation and the use and preservation of messaging apps. DOJ also announced a surge in resources to combat sanctions evasion and export control violations.

A new week brought additional guidance from DOJ, this time the much-anticipated compliance guidance on compensation structures to incentivize compliance and the use of personal devices and messaging apps to engage in business communications. The guidance was announced by the Deputy Attorney General (DAG) Lisa Monaco at the ABA's 38th Annual National Institute on White Collar Crime. Criminal Division Assistant Attorney General (AAG) Kenneth Polite provided greater detail in his keynote address at the same conference. The guidance comes in two forms: (1) a new Criminal Division three-year "pilot program" that will include clawbacks and compensation structures as requirements of criminal resolutions with the Criminal Division, and potential reductions of a resolving company's fine based on compensation that it is able to (or attempts to) claw back from employees who were involved in, or willfully blind to, the misconduct; and (2) revisions to the Criminal Division's Evaluation of Corporate Compliance Programs (ECCP) that add sections on financial incentives for compliance, including clawbacks, and the use of personal devices and messaging apps.

Because the ECCP is in the form of questions that Criminal Division prosecutors will ask companies as part of their evaluation of the companies' compliance programs, these new additions stop short of providing specific policies or procedures that companies are required to adopt. Moreover, we do not yet know how significant or outsized a role these additions will play—particularly for companies that for legitimate reasons (such as labor or employment laws, data privacy or resources) are unable to take significant steps to claw back employee compensation—as compared to other important components of a compliance program. Nonetheless, the new ECCP questions serve as a transparent and useful guide for companies trying to understand DOJ's evaluation of these complex issues.

With respect to the clawback "pilot program," DOJ has sought to incentivize companies that are resolving with the Criminal Division to claw back compensation from employees who were either involved in the underlying misconduct or had supervisory authority over the employees or business areas engaged in the misconduct and knew of, or were willfully blind to, that misconduct. In many cases, this will likely involve litigating such claims. There are several potential issues and concerns with this program, including that (1) it may disproportionately benefit companies in some geographical regions and/or industries with fewer impediments to these types of clawbacks over others, (2) it is likely to disproportionately benefit companies whose misconduct involved senior executives because those are the individuals most likely to have significant amounts of recoupable compensation, and (3) it is likely that companies litigating clawbacks will be forced to turn over discovery related to the underlying investigation and communications with the

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government, potentially giving individuals charged by DOJ early and broader discovery than they otherwise would receive.

The Criminal Division also released a modified version of its monitorship policy, codifying DOJ's practice that monitor selection "be made in keeping with the Department's commitment to diversity, equity, and inclusion," and extending a monitor's "cooling off" period, during which they are prohibited from being employed by or affiliated with the monitored entity, from two years to three years.

Finally, DOJ announced "significant restructuring and resource commitments within the National Security Division," including the addition of "more than 25 new prosecutors who will investigate and prosecute sanctions evasion, export control violations and similar economic crimes." Although there is often a delay (sometimes years-long) between the announcement of additional resources and the realization of more investigations and prosecutions, these changes will undoubtedly have a meaningful impact over the long haul.

1. The pilot program on compensation incentives and clawbacks

The DOJ Criminal Division released the new pilot program on compensation incentives and clawbacks on Friday, March 3. The program will go into effect on March 15, 2023. This new DOJ guidance follows on the heels of recent announcements by the SEC, NYSE, and Nasdaq on clawbacks for publicly traded companies. The program has two key components relating to compliance requirements for criminal resolutions and credit against fines for clawbacks.

A. Compliance requirements for criminal resolutions

According to the program, every Criminal Division corporate resolution will now include a requirement that the company implement criteria related to compliance in its compensation and bonus system and, as part of the company's annual compliance reports to the government (a longstanding requirement of such resolutions), the company will now also be required to report on its implementation of these new criteria. DOJ stated that the criteria "may include, but are not limited to: (1) a prohibition on bonuses for employees who do not satisfy compliance performance requirements; (2) disciplinary measures for employees who violate applicable law and others who both (a) had supervisory authority over the employee(s) or business area engaged in the misconduct and (b) knew of, or were willfully blind to, the misconduct; and (3) incentives for employees who demonstrate full commitment to compliance processes."

The Criminal Division acknowledged that "applicable foreign and domestic law" may create obstacles for some companies, leaving it to prosecutors' discretion to evaluate the company's criteria based on the facts and circumstances of a given case.

B. Credits against fines for clawbacks

In addition to requiring new compensation criteria as part of a compliance program for resolving companies, the pilot program also offers discounts off of the fine amount imposed by DOJ where the company has fully cooperated and remediated, and has demonstrated that it is seeking to "recoup compensation from employees who engaged in wrongdoing in connection with the conduct under investigation, or others who both (a) had supervisory authority over the employee(s) or business area engaged in the misconduct and (b) knew of, or were willfully blind to, the misconduct, and has in good faith initiated the process to recoup such compensation before the time of resolution."

In such circumstances, the Criminal Division "shall accord, in addition to any other reduction available under applicable policy, a reduction of the fine in the amount of 100% of any such compensation that is recouped during the period of

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the resolution." Clawbacks will not have an impact on restitution, forfeiture, disgorgement or other non-fine/penalty amounts. The company will have until the end of the resolution term (usually three years) to actually recoup the money, or otherwise will be required to pay the full amount of the fine.

In addition, even where a company is unable to recoup compensation, so long as it demonstrates a "good faith attempt" to do so, prosecutors have the discretion to reduce the fine by up to 25% of the amount of compensation the company sought to claw back. The guidance goes on to state that "reductions may be warranted where, for instance, a company incurred significant litigation costs for shareholders or can demonstrate that it is highly likely that it will successfully recoup the compensation shortly after the end of the resolution term."

C. Issues and consequences arising from the pilot program

There are a number of issues and consequences (some likely unintended) arising from the new pilot program. As an initial matter, although it only impacts companies that are resolving with the DOJ Criminal Division, companies would likely need to promulgate compensation recoupment policies sooner rather than later in order to put themselves in the best position to take advantage of this program should they ever find themselves in DOJ's crosshairs.

Second, with respect to the credits for clawbacks, companies are only eligible for such credits where they have fully cooperated and remediated. Particularly in conjunction with other recent guidance raising the bar to achieve such a result, prosecutors will have considerable discretion in determining whether a company has qualified for the crediting.

Third, the discounts accorded for clawbacks (or attempted clawbacks) create some interesting, and potentially incongruous, results. There are certain countries and types of companies where clawbacks are more easily executed than others. For example, the EU's labor and employment laws make it difficult to claw back compensation from employees. As a result, the pilot program will likely disproportionately benefit certain companies over others, through no fault of the company.

Similarly, depending on the company, it is often the more senior executives who receive the type of compensation that can be clawed back—i.e., bonuses and equity compensation. Even in cases where most employees receive compensation that can be recouped, it is almost certainly the most senior executives who receive the largest amount of such compensation. As a result, ironically it will be the company whose senior-most executives engaged in or were willfully blind to the misconduct that will be eligible for the biggest benefits under this program (because there will be more to recoup and therefore more to credit).

Lastly, even in countries where clawbacks are permitted, the process to claw back compensation is often protracted, contentious and expensive. In addition, the targeted employee oftentimes has rights and the ability to seek and obtain discovery of relevant materials, which most likely would include the company's underlying investigation and communications with the government. This may mean that culpable individuals who are charged (or even still just being investigated) by the government will get earlier and broader access to discovery than they otherwise would, something that the government oftentimes seeks to avoid by attempting to stay parallel civil cases.

2. Revised compliance guidance

The DOJ Criminal Division also announced revisions to the ECCP, which outlines the questions that prosecutors ask companies in evaluating their compliance programs. The revised guidance now incorporates questions related to financial compensation as a method to incentivize compliance, as well as policies and controls around the use of messaging apps and personal devices.

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Although the guidance is in the form of questions, which each company will answer based on its own unique circumstances and risk profile, the questions do provide insight into DOJ's thinking about these issues. Moreover, many of the questions are leading and reveal DOJ's preferences. For example, DOJ asks whether a company has "policies or procedures in place to recoup compensation that would not have been achieved but for misconduct attributable directly or indirectly to the executive or employee," and "[w]ith respect to the particular misconduct at issue, has the company made good faith efforts to follow its policies and practices in this respect?" In short, this suggests that DOJ expects companies to put in place broad policies to allow it to recoup compensation in the event of misconduct, and to actually enforce those policies when misconduct occurs.

With respect to messaging apps and personal devices, the revised ECCP focuses on three new topics: communication channels, policy environment, and risk management. According to the ECCP, prosecutors will want to know what communication channels the company permits and why, that the company has given thought to how this should vary by jurisdiction and business function, and the mechanisms put in place to preserve electronic communication channels (including with respect to the deletion settings on the apps). Where companies have a "bring your own device" (BYOD) program, prosecutors will want to know what policies are in place and whether the company is permitted to review business communications on personal phones pursuant to the BYOD policy, whether the company has a policy that requires employees to transfer business-related data and information from a personal phone to company platforms, whether these policies are reasonable in light of the company's circumstances and profile, and whether these policies are actually being enforced. Finally, prosecutors will probe what type of controls the company has in place to monitor and ensure compliance with these policies, and what discipline the company has imposed for employees who violate the policies. Whether this policy provides sufficient incentives for companies to revise their retention plans as they relate to messaging apps and personal devices in order to gain some form of "credit" from DOJ should they find themselves under investigation remains to be seen.

3. Modifications to Criminal Division monitorship policy

The Criminal Division also released a revised version of its monitorship policy, largely codifying existing practice. First, it formalized, "[c]onsistent with the Criminal Division's approach for the past several years," that "any submission or selection of a monitor candidate by either the Company or the Criminal Division should be made in keeping with the Department's commitment to diversity, equity, and inclusion, and without unlawful discrimination against any person or class of persons." Second, "consistent with the Criminal Division's practice since at least 2018, many of the requirements for monitors apply to monitor teams, in addition to the titular monitors," including ethical certifications and requirements. And finally, "the cooling off period for monitors [during which the monitor may not be employed by or affiliated with the monitored entity] is now not less than three years, rather than two years, from the date of the termination of the monitorship."

4. Surge in resources to combat sanctions evasion and export control violations

In addition to the new guidance that DOJ announced last week, DAG Monaco also announced that DOJ would be infusing resources into and restructuring the National Security Division "to address the increasing intersection of corporate crime and national security." These resources and restructuring will include adding 25 new prosecutors, appointing the National Security Division's first-ever Chief Counsel for Corporate Enforcement, and issuing "joint advisories with the Commerce and Treasury Departments—akin to the FCPA guidance we have for years published jointly with the SEC—to inform the private sector about enforcement trends and to convey the department's expectations as to national security-related compliance." DAG Monaco also announced a "substantial investment" in the Bank Integrity Unit in the Criminal Division's Money Laundering and Asset Recovery Section, though unlike with

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respect to the National Security Division, the DAG did not specify what this "substantial investment" would entail.

5. Key takeaways

As we have noted for many of the previous guidance announcements over the past few months, these announcements provide yet further transparency and predictability for companies seeking to understand DOJ's view of clawbacks and the use of messaging apps and personal devices.

Nonetheless, it is important to bear in mind that these new aspects of the Criminal Division's ECCP are but two of many other critical components of an effective compliance program, and companies should not place an outsized emphasis on these two items at the expense of other (arguably more important) matters, such as risk assessment, third-party management, an effective reporting mechanism, training and monitoring.

Given the importance of these other aspects of the compliance program, it is interesting that DOJ has chosen to offer potential financial rewards to companies that seek to claw back compensation, but not to companies that, for example, terminate employee wrongdoers, sever relationships with questionable third parties, or have an effective preexisting compliance program at the time of the misconduct.

Likewise, because clawbacks are not attainable by every company, because not all companies have the financial resources to pay large bonuses that can be clawed back, and because companies with executive-level involvement in the misconduct can likely claw back the most compensation, the new pilot program may disproportionately benefit certain companies over others, ironically those with the most egregious and high-level involvement by executives in the wrongdoing.

Lastly, as with most guidance documents, prosecutors still retain a great deal of discretion in determining whether and how to credit companies on all of these fronts, including in determining whether the company fully cooperated and remediated (and therefore is eligible for the clawback credit), whether the company attempted "in good faith" to recoup compensation even when it was unsuccessful (and therefore is eligible for up to 25% credit), and whether the company has satisfactorily answered the questions in the ECCP.

With that said, companies should consider implementing—where local law permits—policies that permit them to recoup compensation from employees who engage in wrongdoing or are supervisors who knew of or were willfully blind to misconduct. Moreover, companies should consider implementing—again, where local law permits—policies governing messaging apps and personal devices that make clear:

- What messaging platforms and devices are permitted to be used for business communications;
- The requirements and prohibitions for using personal devices and messaging apps for business;
- The expectations for business communications that occur on non-approved platforms and devices (e.g., that they be transferred to approved platforms);
- The retention expectations for data and information on approved platforms, including what the deletion settings (to the extent the platform has them) should be set to; and
- What the disciplinary consequences would be for failing to comply with these policies.

Companies should also consider training employees on these policies and taking steps to monitor and enforce violations of them.

Finally, although we do not expect that the surge in resources to combat sanctions evasion and export control violations will have an immediate impact, this move is consistent with messaging from the DOJ for the past 18 months and is likely

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to have a meaningful impact over time.

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October 24, 2023

Dodd-Frank Clawback Policies: For Initial Listings, the Time is Now

Now that the effective date of October 2nd has passed for the listing standards that implement Exchange Act Rule 10D-1, listed companies that have not already adopted a Dodd-Frank clawback policy have only a few weeks to do so before the compliance deadline of December 1st. But as suggested by the NYSE letter that we blogged about last month, companies applying for initial listing may have less leeway. In our "Q&A Forum" (#1487), a member recently asked about this:

> In the NYSE issuer notification that went out a few weeks ago re clawbacks, it provided that "In addition, issuers submitting initial applications for securities to be listed on or after October 2, 2023 will be required to confirm the adoption of a compensation recovery policy as part of its listing application in Listing Manager." So far, we have not seen an earlier deadline than December 1, 2023 being applied to Nasdaq initial listing applications. Is anyone aware of Nasdaq's position?

Here's what John said:

> I have not seen any notice from Nasdaq, but the form of Corporate Governance Certification that's required to be submitted for a new listing application that appears on Nasdaq's website does include a new Section 5C, which requires a company to certify that it has adopted a clawback policy conforming to Rule 5608. That suggests to me that Nasdaq is requiring companies that are applying for listing after the October 2, 2023, effective date of the rule to have a policy in place.

As Meredith noted back in June, both NYSE 303A.14 and Nasdaq Rule 5608 are subject to cure periods for non-compliance. The NYSE covers that in 302.01F, and for Nasdaq, check out the 5800 series, particularly Rule 5810.

> We are continuing to post memos, sample policies, and other practical resources in our "Clawbacks" Practice Area – I have also been finding the May-June issue of *The Corporate Executive* newsletter extremely helpful as I put the finishing touches on policies and help clients understand the ins & outs.

Since this is such a hot topic and we're getting in to the 11th hour, make sure to also mark your calendars for the webcast that we've just scheduled for Thursday, November 16th at 2pm Eastern – "More on Clawbacks: Action Items and Implementation Considerations." This is a follow-up to the excellent conversation that occurred at our "20th Annual Executive Compensation Conference," because it was clear from that session that there are *many* questions bubbling up about these policies and how they'll be implemented. If you missed the essential conversation at the Conference, you can still get access to the video archives & transcripts by emailing sales@ccrcorp.com or calling 800-737-1271.

– **Liz Dunshee**

Posted by Liz Dunshee
Permalink: https://www.compensationstandards.com/member/blogs/consultant/2023/10/dodd-frank-clawback-policies-for-initial-listings-the-time-is-now.html

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August 23, 2023

Clawbacks: Enforcement Complications Under Foreign Law

As Liz shared when the final clawback rules were released, there are only three limited exceptions to enforcing a Dodd-Frank clawback policy:

– if direct expenses paid to third parties to assist in enforcing the policy would exceed the amount to be recovered and the issuer has made a reasonable attempt to recover;

– if recovery would violate home country law that existed at the time of adoption of the rule (November 28, 2022) and the issuer provides an opinion of counsel to that effect to the exchange; or

– if recovery would likely cause an otherwise tax-qualified retirement plan to fail to meet the requirements of the IRC.

This recent Mayer Brown alert addresses the first two exceptions in more detail and discusses complications for companies incorporated in foreign jurisdictions or with executives working abroad. The memo reminds us that "home country law" is limited to the laws of the issuer's country of incorporation and does not address complications due to the country where the executive works:

> For companies that have executives working in foreign countries where enforcement may fall under the local laws of that country, the company must be able to enforce the clawback requirements or rely on the Direct Expense Exception. […] However, to rely on [the Direct Expense Exception], the company must first make a reasonable attempt to recover the requisite compensation and document the recovery efforts. To be deemed to be impracticable, the direct costs paid to a third party to assist in enforcing recovery, such as legal expenses and consulting fees, must exceed the erroneously awarded compensation amounts.

It goes on to discuss how these two exceptions would be invoked:

> For each of these exceptions, the determination would have to be made by a committee of independent directors responsible for executive compensation decisions, such as a compensation committee, or in the absence of such a committee, by a majority of the independent directors. In addition, as discussed below, the company would need to disclose why it did not pursue the recovery. The determination is subject to review by the applicable exchange.

The memo then details local laws applicable to a clawback in each of Brazil, China, France, Germany, Hong Kong, Singapore, the UAE & the UK, the availability of offsets against future compensation and steps companies can take now to increase the likelihood of enforceability in each jurisdiction.

– **Meredith Ervine**

Posted by Meredith Ervine
Permalink: https://www.compensationstandards.com/member/blogs/consultant/2023/08/clawbacks-enforcement-complications-under-foreign-law.html

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June 15, 2023

Dodd-Frank Clawbacks: Handling the Broad "Indemnification" Prohibition

One of the common questions that companies are facing with respect to the (thankfully extended) Dodd-Frank clawback policy rule is whether the prohibition on indemnifying covered executives against the loss of erroneously awarded compensation means that the company cannot cover executives' legal costs in connection with a clawback dispute. K&L Gates' Ali Nardali sent me this view:

> "Indemnification" is used pretty broadly in the release and covers legal costs:
>
> > "The Proposing Release acknowledged that state indemnification statutes, indemnification provisions in an issuer's charter, bylaws, or general corporate policy and coverage under directors' and officers' liability insurance provisions may protect executive officers from personal liability for costs incurred in a successful defense against a claim or lawsuit resulting from the executive officer's service to the issuer. However, Section 10D's listing standard requirement that "the issuer will recover" is inconsistent with indemnification because a listed issuer does not effectively "recover" the excess compensation from the executive officer if it has an agreement, arrangement, or understanding that it will mitigate some or all of the consequences of the recovery."
>
> We do not believe that it is necessary to amend indemnification agreements, because the release contemplates that they are auto-nullified to the extent they are inconsistent with the clawback rule, per Section 29(a) of the '34 Act.

– **Liz Dunshee**

Posted by Liz Dunshee
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← Tomorrow's Webcast: "Pay Vs. Performance – Lessons From Season 1" | Main | Say-on-Pay Frequency: Don't Forget to Report Your Decision on Frequency! →

June 13, 2023

Dodd-Frank Clawbacks: SEC Approves Amended Exchange Proposals

Here's the good news that Meredith blogged yesterday on TheCorporateCounsel.net:

> Liz blogged last week that the NYSE and Nasdaq proposed amendments to their listing standards to implement the Dodd-Frank clawback rules. The amendments would extend the effective date of the rules to October 2, 2023. The consequence is that companies will have until December 1, 2023 to adopt compliant clawback policies and that they'll apply to incentive-based compensation received by executive officers on or after October 2, 2023.
>
> The open question was whether & how the SEC would approve these amendments, since Friday was the last day that they could act on the original proposals. The Commission came through at the 11th hour with notices for the NYSE and Nasdaq (and other exchanges) that granted accelerated approval of each exchange's proposal, as modified by the amendment.
>
> Although a number of companies have already adopted a Dodd-Frank clawback policy in anticipation of these listing standards, there are also a significant number who were going to be attempting to cram it into summer board agendas. This is a welcome development that gives companies & boards more breathing room to carefully consider their policies. We've posted several helpful samples in our "Clawbacks" Practice Area for members of this site!

This FW Cook blog has a nice chart that summarizes regulatory developments to-date on this topic. As is the case with any new rule, there are some lingering interpretive & implementation questions. We'll be discussing these questions and sharing practical pointers for handling them at our "Clawbacks – Key Action Items Now" session of our "20th Annual Executive Compensation Conference," which is combined with our "Proxy Disclosure Conference" and happening virtually September 20th – 22nd. Register today for this pair of conferences to get all the info you need – and ongoing access to the archives afterwards. You can sign up online or email sales@ccrcorp.com.

– **Liz Dunshee**

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