

New Executive Clawback Requirements Coming in 2023

Article By:

Kelly Simoneaux

Rachel Solino

Earlier this fall, the SEC adopted [final rules](#) implementing the “clawback policy” mandate under Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. This rule adoption follows proposed rules originally issued in July 2015 and two comment periods in October 2021 and June 2022. Under the final rules, stock exchanges must adopt listing standards requiring issuers to implement policies for the recovery of erroneously issued incentive-based compensation. Listed companies that do not adopt and comply with such policies will be subject to delisting.

Timing of Implementation

- Stock exchanges must propose listing standards requiring listed companies to adopt and implement written policies providing for the recovery of incentive compensation under certain conditions by February 27, 2023.
- The proposed listing standards must become effective by November 28, 2023.
- Listed companies must adopt a compliant clawback policy within 60 days after the listing standards become effective.

Scope of Clawback Policies Under the Final Rules

The final rules dictate the minimum standards that must apply to clawback policies, but the stock exchanges may adopt additional requirements. The final rules include standards that are more expansive than the existing clawback requirements under Section 304 of the Sarbanes-Oxley Act of 2002 (SOX). Notably, recovery of compensation under Section 304 of SOX is predicated on a restatement caused by material noncompliance with financial reporting requirements due to misconduct, whereas the final rules require recovery in connection with a restatement, regardless of fault or misconduct.

-
- **Subject Companies** — All listed companies (with limited exceptions) will be subject to the requirements, including smaller reporting companies, emerging growth companies, controlled companies, and foreign private issuers.
 - **Covered Officers** — The policy must cover current and former “officers” as defined under Rule 16a-1(f) under the Securities Exchange Act of 1934 (the Exchange Act); thus, this could include a listed company’s principal accounting officer or, if none, the controller, even if they are not an executive officer.
 - **Triggering Events** — The policy will be triggered by a restatement due to material noncompliance with financial reporting requirements, including both “big R” and “little r” restatements.
 - A “big R” restatement corrects errors that are material to previously issued financial statements, whereas a “little r” restatement corrects errors that are not material to previously issued financial statements but would result in a material misstatement if the errors were left uncorrected in the current report or the error correction was recognized in the current period.
 - **Covered Period** — The policy will apply to compensation received during the three fiscal years preceding the date the restatement was “required.” A company is deemed to be “required” to prepare a financial restatement upon the earlier of the following:
 - The board of directors, a committee thereof, or any of the officers *concluded or reasonably should have concluded* that the company is required to prepare an accounting restatement due to material noncompliance of the company with any financial reporting requirement.
 - A court, regulator, or other legally authorized body directs the company to prepare an accounting restatement.
 - **Compensation Subject to Clawback** — The policy must require covered officers to reimburse the listed company for any overpayment of incentive compensation “received” by the officer during the “covered period” (defined above), which is calculated as the excess paid over what would have been paid based on the restated financial information.
 - “Incentive compensation” subject to the policy includes any compensation that is granted, earned, or vested based wholly or in part upon the attainment of a financial reporting measure, which includes stock price or total shareholder return. Further, the amount subject to recovery is calculated on a pre-tax basis.
 - Incentive compensation is “received” during the fiscal period in which the performance measure that must be achieved based on the terms of the award is attained (not when it is granted, vested, or paid).
 - The policy will apply to incentive compensation that is “received” after the listing standards become effective.

-
- **Limited Discretion** — The listed company’s board will have little to no discretion to forgo, release, or settle amounts owed under the policy. Further, the final rules require listed companies to recover amounts due under the policy “reasonably promptly” and do not permit companies to indemnify their officers for losses related to the policy.
 - The final rules provide for the following limited “impracticability” exceptions, permitting listed companies to forgo enforcing the clawback policy if any of the following are true:
 - Direct expenses paid to third parties to assist in enforcing the policy would exceed the amount to be recovered and the listed company has made a reasonable attempt to recover the compensation.
 - Recovery would violate home country law that existed at the time of adoption of the final rule, and the listed company provides the exchange with an opinion of counsel to that effect.
 - Recovery would likely cause an otherwise tax-qualified retirement plan to fail to meet the requirements of the Internal Revenue Code.

Disclosure Requirements

The final rules require significant disclosures regarding the listed company’s clawback policy and the actions taken in connection with a triggering restatement. In addition, issuers will be required to use Inline XBRL to tag their compensation recovery disclosures.

- **Form 10-K:**

- The listed company’s compliant clawback policy must be included as an exhibit.
- The cover page of the Form 10-K will include two new checkboxes indicating:
 - Whether the financial statements included in the filing reflect the correction of an error to previously issued financial statements.
 - Whether any of those error corrections are restatements that required a recovery analysis pursuant to the clawback policy.

- **Proxy Statement:**

- If, during the listed company’s last completed fiscal year, it (i) completed a restatement that required it to recover compensation under its clawback policy or (ii) had an outstanding balance to be recovered from the application of the policy to a prior restatement, then new Item 402(w) of Regulation S-K requires the company to disclose the information below.
 - For each restatement:
 - Disclose the date the listed company was required to prepare an

accounting restatement, the aggregate dollar amount of erroneously awarded compensation attributable to such accounting restatement (including, if applicable, a description of any estimates used in calculating the recoverable amount), and the aggregate amount that remains outstanding.

- If the aggregate amount due has not yet been determined, explain why and disclose the above information in the next filing required to disclose the above information.
- For any outstanding amounts due from any current or former named executive officer for 180 days or more, identify the officer and the amount due.
- Details regarding reliance on the impracticability exceptions, if applicable.
- Details regarding the company's conclusion that a restatement during or after its last completed fiscal year did not result in recoverable compensation under its policy, if applicable.
- Any recovered amounts should also be reflected in the Summary Compensation Table and related footnotes.

Next Steps

Although most listed companies have implemented some form of clawback policy, it is unlikely that current policies will be compliant with the new requirements. Companies can begin preparing for the new listing standards by:

- Evaluating their current clawback policies and considering how best to revise or supplement them to reflect the new requirements.
- Reviewing outstanding incentive-based compensation arrangements to identify which arrangements will be subject to the new policy and determine whether changes are needed to support potential recovery.
- Developing internal communication plans to advise covered officers of their obligations under the new policies.
- Considering the internal processes and controls, including those at the board level, that will be necessary to implement the new policy if a triggering event occurs.

Source URL: <https://natlawreview.com/article/new-executive-clawback-requirements-coming-2023>