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Securities Alert: SEC Proposes Executive Compensation Clawback Rules

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On July 1, 2015, the SEC issued proposed rules that would require listed issuers to:

- adopt and comply with a policy requiring the recovery of excess incentive-based compensation from the issuer's executive officers in the event of material accounting restatements; and
- disclose the listed issuer's clawback policy and certain information relating to the application of such clawback policy.

Proposed Clawback Policy Requirements

The proposed rules are intended to implement the provisions of Section 954 of the Dodd-Frank Wall Street Reform and Protection Act of 2010 and Section 10D of the Securities Exchange Act of 1934, as amended, by directing the national securities exchanges and associations to adopt new listing standards that would prohibit the listing of securities of issuers who fail to comply with clawback policy adoption, recovery and disclosure requirements. The mandated clawback policies would require a listed issuer to recover excess incentive-based compensation received by its executive officers during the three completed fiscal years immediately preceding the date the issuer is required to prepare an accounting restatement to correct an error that is material to previously issued financial statements.

Who is subject to clawback policies?

All current and former executive officers of companies with securities listed on a national securities exchange or association would be subject to the clawback policy. For purposes of the proposed rules, executive officers include an issuer's president, principal financial officer, principal accounting officer, any vice-president of the issuer in charge of a principal business unit, division or function, any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer. Executive officers of the issuer's parent or subsidiaries would also be deemed executive officers if they perform similar policy making functions for the issuer. This definition mirrors the definition of "officer" under Section 16 of the

Exchange Act as opposed to the narrower definition of named executive officer used for proxy statement compensation disclosure.

What compensation is subject to recovery?

The proposed rules define the amount of recoverable compensation 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.” Recovery would be required regardless of whether any misconduct occurred or whether the executive officer had responsibility for the error in the financial statements.

What constitutes incentive-based compensation?

The proposed rules define “incentive-based compensation” as any compensation that is granted, earned or vested based wholly or in part on the attainment of any financial reporting measure. “Financial reporting measures” include measures that are determined and presented in accordance with the accounting principles used in preparing the issuer’s financial statements, any measures derived wholly or in part from such financial information, and stock price and total shareholder return. For incentive-based compensation based on stock price or total shareholder return, the amount of recoverable compensation may be determined based on a reasonable estimate of the effect of the accounting restatement on the applicable measure.

When is compensation deemed received?

Incentive-based compensation would be deemed received for purposes of the proposed rules in the period in which the applicable financial reporting measure is attained, even if the payment or grant occurs after the end of that period.

Are there any exceptions to the application of the clawback policy?

Recovery would not be required if the compensation committee (or, if there is no such committee, a majority of the board’s independent directors) of the listed issuer determines that (i) it would be impracticable to seek recovery because the direct costs of enforcing recovery would exceed the recoverable amounts or (ii) recovery would violate the issuer’s home country law.

Proposed Clawback Disclosure Requirements

A listed issuer would be required to file its clawback policy as an exhibit to its annual report.

A listed issuer would also be required to disclose the following information if at any time during its last completed fiscal year either (i) a restatement that required recovery of excess incentive-based compensation pursuant to the issuer’s compensation clawback policy was completed or (ii) there was an outstanding balance of excess incentive-based compensation from the application of that policy to a prior restatement:

- for each restatement, the date on which the issuer was required to prepare an accounting restatement, the aggregate dollar amount of excess incentive-based compensation attributable to the accounting

restatement and the aggregate dollar amount of excess incentive-based compensation that remains outstanding at the end of its last completed fiscal year;

- the estimates used to determine the excess incentive-based compensation attributable to such accounting restatement, if the incentive payment related to a stock price or total shareholder return metric;
- the name of each person subject to recovery of excess incentive-based compensation attributable to an accounting restatement from whom the issuer decided during the last completed fiscal year not to pursue recovery (if any), the recovery amount forgone for each such person and a brief description of the reason the issuer decided in each case not to pursue recovery; and
- the name of, and amount due from, each person from whom, at the end of the issuer's last completed fiscal year, excess incentive-based compensation had been outstanding for at least 180 days since the date the issuer determined the amount the person owed.

The proposed rules would also require any amounts recovered from a named executive officer pursuant to a listed issuer's clawback policy to be reflected in the issuer's Summary Compensation Table in the appropriate columns for the fiscal year in which such amounts were initially reported and be identified in a footnote to the table.

Companies Subject to Proposed Clawback Rules

The proposed rules would apply to all companies with securities listed on a national securities exchange or association, including emerging growth companies, smaller reporting companies and foreign private issuers.

Effectiveness of Clawback Rules

The clawback rules are unlikely to be effective for the 2016 proxy season given the large number of comments expected on the proposed rules, the customary period between the release of proposed rules and the adoption of final rules and the need for the securities exchanges and associations to establish new listing standards regarding clawback policies following the SEC's adoption of final rules.