

SEC Adopts Final Clawback Rules

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After a long wait, the Securities and Exchange Commission has adopted [final rules](#) on clawbacks of executive compensation required under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.¹ The final rules direct the national securities exchanges to adopt listing standards that require most exchange-listed issuers to adopt and comply with written clawback policies, and to provide disclosure regarding those clawback policies and amounts recovered. This Debevoise In Depth describes the final clawback policy requirements and the new disclosures related to these policies.²

Covered Issuers

The final clawback rules generally apply to all listed issuers, including foreign private issuers (“FPIs”), smaller reporting companies, emerging growth companies, controlled companies and debt-only filers.

The rule exempts only the listing of certain security futures products, standardized options, securities issued by unit investment trusts and securities issued by certain registered investment companies. In addition, the rules exempt listed funds that have not awarded incentive-based compensation to any current or former executive officer in any of the last three fiscal years (or since their initial listing if listed for less than three fiscal years).

Clawback Policy Requirements

Under these final rules, an issuer’s written clawback policy must provide that if an issuer is required to prepare an accounting restatement, the issuer must recover all incentive-

¹ The SEC [proposed rules](#) in 2015 and reopened the comment period in [October 2021](#) and again in [June 2022](#).

² The SEC has nearly completed its executive compensation-related rulemaking under the Dodd-Frank Act, with only the proposed rules under Section 956 (related to the disclosure of, and prohibitions of, certain executive compensation arrangements at large financial institutions) remaining.

based compensation that was erroneously received by any current or former executive officer during the three years preceding the date such a restatement was required. The recoverable amount is the amount of incentive-based compensation received on a pre-tax basis in excess of the amount that otherwise would have been received had it been determined based on the restated financial measure.

Accounting Restatements That May Trigger Recovery

Under the final rules, the clawback policy will be triggered in the event the issuer is required to prepare an accounting restatement due to material noncompliance of the issuer with any financial reporting requirements under the securities laws, including any accounting restatement that corrects an error in previously issued financial statements that is material to the previously issued financial statements (a “Big R” restatement) or that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period (a “little r” restatement).

The SEC did not provide definitions of accounting restatement or material noncompliance on the grounds that existing accounting standards and guidance already set out the meaning of these terms. The adopting release lists changes to an issuer’s financial statements that do not represent error corrections (and thus would not trigger application of the clawback policy), such as out-of-period adjustments and retrospective applications of a change in accounting principles.

Covered Executive Officers

An issuer’s clawback policy under the final rules must require recovery of incentive-based compensation received (as defined below) by a person (1) after beginning service as an executive officer and (2) if that person served as an executive officer at any time during the recovery period. Recovery of compensation received while an individual served in a non-executive role prior to becoming an executive officer is not required.

The definition of “executive officer” for purposes of the final clawback rules is consistent with the term “officer” for Section 16 purposes.³ The final rules provide that executive officers for purposes of the final rules would include, at a minimum, the executive officers identified pursuant to Item 401(b) of Regulation S-K.

³ An executive officer means 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 (such as sales, administration or finance), 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(s) or subsidiaries are deemed executive officers of the issuer if they perform such policy-making functions for the issuer. When the issuer is a limited partnership, officers or employees of the general partner(s) who perform policy-making functions for the limited partnership are deemed officers of the limited partnership. Policy-making functions only include such functions that are significant.

Incentive-Based Compensation Subject to Potential Clawback

The clawback policy applies to incentive-based compensation—i.e., compensation that is *granted, earned or vested* based wholly or in part upon the attainment of a *financial reporting measure*. Financial reporting measures are measures that are determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements and any measures derived wholly or in part from such measures. Financial reporting measures also include measures based on stock price and total shareholder return ("TSR").

Under the final rules, the clawback policy would not apply to compensation that does not meet the definition of incentive-based compensation, such as salaries, discretionary or subjective awards, and equity awards where the grant is not contingent on achieving any financial measures and vesting is solely based on length of service or the passage of time (e.g., time-vesting stock options). In addition, awards that are earned solely upon satisfying one or more operational performance measures (e.g., opening a specified number of stores, completion of a project or increase in market share) or strategic measures (e.g., consummating a merger or divestiture) are also not considered incentive-based compensation subject to clawback under the SEC's final rules.

Applicable Time Periods

The clawback policy must apply to incentive-based compensation received during the three-year period preceding the date the issuer is required to prepare the accounting restatement:

- Compensation is deemed "**received**" in the fiscal period during which the specified performance goals are attained, even if the payment or grant of such award (or the determination that an award is payable) occurs after the end of that period or if there are outstanding conditions to be satisfied (e.g., service-based vesting).
- The "**date the issuer is required to prepare the accounting restatement**" means the *earlier of* (1) the date the board of directors or its committee (or officer(s) of the issuer if board action is not required) conclude, or reasonably should have concluded, that the issuer is required to prepare an accounting restatement due to the material noncompliance with any financial reporting requirement under the securities laws; or (2) the date a court, regulator or other legally authorized body directs the issuer to prepare an accounting restatement.
- The **three-year lookback period** for the clawback policy will comprise the three completed fiscal years immediately preceding the date the issuer is required to prepare an accounting restatement for a given reporting period.

By way of example, if a calendar year issuer concludes in November 2025 that a restatement of previously issued financial statements is required and files the restated financial statements in January 2026, the clawback policy would apply to incentive-based compensation received by current and former executive officers in 2022, 2023 and 2024. Compensation potentially subject to recovery would include incentive-based compensation earned on the basis of performance against financial reporting performance measures during 2022, 2023 and 2024, even if such compensation became vested or payable in later years. Compensation paid in 2022 with respect to a performance period ended at or before December 31, 2021 would not be subject to the clawback.

Applying the Clawback Policy

Once the clawback obligation is triggered, the issuer would be required to recover any erroneously awarded compensation.

Calculation of Erroneously Awarded Compensation

Under the final rules, *erroneously awarded compensation* means the amount of incentive-based compensation received by the executive officer that exceeds the amount that would otherwise have been received had it been determined based on the restated amounts, determined on a *pre-tax* basis. This means that the amount subject to recovery is the gross amount paid above what should have been payable and is not reduced by the taxes or tax withholding applicable to such amount.⁴ Where incentive-based compensation is based only in part on the achievement of a financial reporting measure, the issuer would first need to determine the portion of the previously paid incentive-based compensation based on or derived from the restated financial reporting measure.

For any incentive compensation based on stock price or TSR, the amount must be based on a reasonable estimate of the effect of the accounting restatement on stock price or TSR. The issuer must maintain documentation of its determination of a reasonable estimate and provide the documentation to the exchange.

The adopting release for the final rules provides the following specific guidance on calculating erroneously awarded compensation:

⁴ We note that it may be unclear under current U.S. federal income tax laws whether an executive would be entitled to relief for amounts repaid in a tax year following the year when they were first received by the executive. The adopting release recognizes that the clawback may impose a tax burden on executives but notes that “the extent to which a tax system allows current adjustments for tax paid in prior periods under assumptions that later prove incorrect is a matter of tax policy outside the scope of this rulemaking.”

- For **cash awards**, the erroneously awarded compensation is the difference between the amount of the cash award that was received and the amount that should have been received applying the restated financial reporting measure.
- For **cash awards paid from bonus pools**, the erroneously awarded compensation is the pro rata portion of any deficiency that results from the aggregate bonus pool that is reduced based on applying the restated financial reporting measure.
- For **equity awards**, if the shares, options or SARs are still held at the time of recovery, the erroneously awarded compensation is the number of such securities received in excess of the number that should have been received applying the restated financial reporting measure (or the value of that excess number). If the options or SARs have been exercised, but the underlying shares have not been sold, the erroneously awarded compensation is the number of shares underlying the excess options or SARs (or the value thereof).

Method of Recovery

The final rules permit issuers to exercise discretion in how to accomplish recovery, acknowledging that the appropriate means of recovery may vary by issuer and by compensation arrangement. Regardless of the means used, issuers should recover erroneously awarded compensation “reasonably promptly” under the final rules. The adopting release notes, as an example, that an issuer may be acting reasonably promptly by establishing a deferred payment plan that allows the executive officer to repay erroneous compensation as soon as possible without unreasonable economic hardship to the executive officer, depending on the facts and circumstances.

Limited Board Discretion

Erroneously awarded compensation must be recovered by the board of directors in accordance with the clawback policy unless (1) one of the three specific exceptions described below are applicable, and (2) the independent compensation committee or majority of independent directors serving on the board has made a determination that recovery would be impracticable. These three specific exceptions are:

- The direct expense paid to a third party to assist in enforcing the policy would exceed the amount recovered (provided that, before concluding so, the issuer has made a reasonable attempt to recover the compensation, documented the attempts, and delivered the documentation to the exchange).
- Recovery would violate *the issuer’s* home country law where that law was adopted prior to the effective date of the final clawback rules (provided that, before

concluding so, the issuer has obtained an opinion of home country counsel, delivered to and deemed acceptable by the applicable securities exchange).

- Recovery would likely cause an otherwise tax-qualified plan to fail to meet the requirements of Section 401(a)(13) or Section 411(a) of the Internal Revenue Code and the regulations promulgated thereunder.

No Indemnification

Consistent with the 2015 proposed rules, the final rules prohibit issuers from insuring or indemnifying any executive officer or former executive officer against the loss of erroneously awarded compensation or paying or reimbursing for the cost of third-party insurance purchased by such officer to fund potential clawback obligations. Issuers may be well served to begin to review their indemnification and insurance policies, as well as any contractual arrangements with their executive officers, to determine whether any changes will be required to these arrangements.

New Disclosures on Clawback Policies

The final rules require new disclosures regarding the issuer's clawback policy and any recoveries under such policy. As a reminder, issuers who are required to have a Compensation Discussion & Analysis under Item 402(b) are already required to disclose, if material, their policies and decisions regarding adjustment or recovery of named executive officer ("NEO") compensation if the relevant performance measures are restated or adjusted in a manner that would reduce the size of an award or payment.

New Exhibit Filing Requirement

The final rules add to Item 601 of Regulation S-K a requirement that the clawback policy be filed as an exhibit to the issuer's annual report on Form 10-K.

New Cover Page Check Boxes

In addition, the final rules also add check boxes to the cover pages of Forms 10-K, 20-F and 40-F that indicate separately:

- whether the financial statements included in the filing reflect correction of an error to previously issued financial statements, and
- whether any of those error corrections are restatements that require a recovery analysis of incentive-based compensation received by any of the applicable executive officers during the relevant recovery period.

Required Disclosures in the Event of a Restatement

Clawback Recovery Disclosures

If during (or after) the last completed fiscal year the issuer was required to prepare an accounting restatement that required recovery pursuant to a clawback policy, the issuer must disclose the following information under new Item 402(w) of Regulation S-K:

- the date on which the registrant was required to prepare an accounting restatement;
- the aggregate dollar amount of erroneously awarded compensation attributable to the restatement, including an analysis of how the amount was calculated (including, in the case of stock price or TSR metrics, the estimates used and an explanation of the methodology used for such estimates) or, if the amount has not yet been determined, an explanation of the reasons and disclosures of the amount and other required information in the next filing that requires Item 402 disclosure;
- the aggregate dollar amount of erroneously awarded compensation that remains outstanding at the end of the last completed fiscal year;
- any outstanding amounts due from any current or former NEO that had been outstanding for 180 days or longer; and
- if recovery would be impracticable (as discussed above under “*Limited Board Discretion*”), the amount of recovery forgone for each current and former NEOs and for all other current and former executive officers as a group, and a brief description of the reason(s) the issuer decided in each case not to pursue recovery.

These above disclosures are also required in the event there is an outstanding balance as of the end of the last completed fiscal year of erroneously awarded compensation to be recovered from a prior restatement. In addition, the forms applicable to foreign private issuers and listed funds will also require these same disclosures.

Summary Compensation Table Reporting

In the event of a recovery under the clawback policy for an NEO, the issuer can reduce the amount previously reported in the Summary Compensation Table for the fiscal year in which the amount was initially reported. It should be noted that, depending on the type of compensation in question and the year in which the recovery occurs, the year in which the compensation was initially reported may no longer be listed in the Summary Compensation Table or the compensation of the effected executive officer may not have been reported for such year.

Disclosure with Respect to Restatements That Do Not Require Recovery

If at any time during (or after) its last completed fiscal year the registrant was required to prepare an accounting restatement, and the registrant concluded that recovery of erroneously awarded compensation was not required pursuant to the issuer's clawback policy, the issuer must briefly explain why application of the recovery policy resulted in this conclusion.

Inline XBRL Requirement

The final rules require tagging of specific data points included within the clawback disclosures, as well as block text tagging of the disclosures, in Inline XBRL.

What's Next?

Each securities exchange has 90 days to file its proposed listing standards implementing the final rules following publication of the rules in the federal register. The proposed listing standards must become effective within one year after publication of the SEC's final rules. Issuers then will have 60 days after the applicable listing standards become effective to amend their existing clawback policies or adopt new policies in compliance with the listing standards. The new disclosures are required on or after the date on which the applicable exchange's listing standards become effective.

There is limited transition relief under the final rules. The clawback policy applies to all incentive-based compensation received (as defined above) by executive officers on or after the effective date of the exchange's listing standards, even if such compensation was awarded or granted prior to such effective date.

There are actions that issuers can begin taking now, which include the following:

- educate boards, compensation committees and executive officers about the final clawback rules;
- review existing clawback policies to identify areas of potential change and/or begin to draft new policies, including an evaluation of the pros and cons of retaining or adopting more stringent clawback policies than what the final rules require (e.g., with longer look-back periods, additional compensation subject to recovery or covering more employees in the organization);
- review indemnification and insurance policies and contractual commitments to executives;

- include references to clawback obligations in executive officer employment agreements and equity and bonus programs; and
- reference clawback obligations in any separation or settlement agreement with any departing executive officer.

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Please do not hesitate to contact us with any questions.

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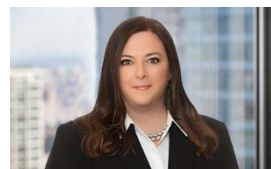
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