

PUBLICATION

SEC Proposes Rules Requiring Clawback of Incentive Compensation in Connection With Accounting Restatements [Ober|Kaler]

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A periodic bulletin keeping small businesses informed about current developments in securities law and related matters.

As required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), the Securities and Exchange Commission (SEC) has proposed new Rule 10D-1 under the Securities Exchange Act of 1934, which would require companies with securities listed on a national securities exchange or national securities association to adopt a written policy providing for the recovery of "erroneously awarded incentive-based compensation" if the company is required to prepare an accounting restatement due to "material noncompliance... with any financial reporting requirement under the securities laws." These types of policies are often referred to as "clawback" policies. The SEC also proposed amendments to its executive compensation disclosure rules that would require listed companies to disclose specified information in connection with their clawback policies. The release proposing the new requirements is available [here \[PDF\]](#).

As proposed, a listed company's clawback policy must apply to incentive-based compensation that was received by an executive officer (or former executive officer) of the company during the three completed fiscal years immediately preceding the date that the issuer is required to prepare a restatement of its previously issued financial statements to correct a material error, assuming the company was listed on the exchange or association when the compensation was received. Whether or when restated financial statements are filed, however, as well as whether there was any fault or misconduct on the part of the executive or even company itself, is not relevant. Under the proposed rule, compensation is incentive-based if it is "granted, earned or vested based wholly or in part upon the attainment of ... measures that are determined and presented in accordance with the accounting principles used in the ... financial statements, any measures that are derived wholly or in part from such measures, and stock price and total shareholder return" (TSR). The amount the company must recover would be the amount of incentive-based compensation that exceeds the amount of such compensation the executive officer would have been entitled to as determined under the restated financial statements, without regard to taxes paid on such amounts. If any such incentive-based compensation was based on TSR or stock price, the company must recover the excess based upon a reasonable estimate of the impact the restatement would have had upon stock price or TSR and maintain (and provide to the exchange or association) documentation in that regard.

Listed issuers would have to file a copy of their clawback policy as an exhibit to their Annual Report on Form 10-K. Any amounts recovered pursuant to such policy would be deducted from the amounts listed in the company's summary compensation table for the applicable year, with footnote disclosure of the amount recovered. In addition, when, during its last completed fiscal year, a listed company had a restatement that required recovery of excess compensation or it was owed a payment under its clawback policy due to a prior restatement, the company will be required to disclose in its Annual Report on Form 10-K or annual proxy statement: (1) with respect to each restatement (i) the date on which it was required to prepare an accounting restatement (generally the date the company determined it was required to or was ordered by a court or regulator to prepare an accounting restatement, consistent with Item 4.02(a) of Form 8-K), (ii) the aggregate amount of excess incentive-based compensation attributable to such restatement, (iii) if such compensation was based on TSR or stock price, the estimates used to determine the excess incentive-based compensation

attributable to the restatement, and (iv) the aggregate amount of excess incentive-based compensation outstanding at the end of the last fiscal year; (2) if during the year the company decided not to attempt to recover excess incentive-based compensation from any individual, the name of such individual, the amount foregone, and the reasons why; (3) the name of each individual who owed the company repayment of excess incentive-based compensation as of the end of the fiscal year if such amount has been outstanding 180 days or more since the date the company determined it was owed such compensation under its clawback policy. This disclosure must be provided in eXtensible Business Reporting Language (XBRL).

Notably, the rules prohibit companies from indemnifying their current or former executive officers for amounts required to be repaid to the company in compliance with its clawback policy or from providing insurance in that regard.

Applicability and Transition Provisions

As proposed, the new rule and disclosure requirements would apply to all listed companies including smaller reporting companies. The proposed rule includes limited exemptions for registered management investment companies that do not pay their officers incentive-based compensation, companies that only list security futures products and standardized options and unit investment trusts, and for recovery of erroneously awarded compensation when the cost of such recovery would exceed the amount that could be recovered (after making a reasonable attempt to recover the compensation) or, with respect to foreign private issuers, if compliance would conflict with a home country law adopted prior to the date the proposal is published in the *Federal Register*. A company's board would have no discretion as to whether to seek recovery of erroneously awarded incentive-based compensation under the proposal.

As proposed, the national securities exchanges and associations would have to adopt a final rule to implement the provisions of Rule 10D-1 within one year after the rule becomes effective, and listed companies would have 60 days after the effective date of the listing standard to implement their clawback policies.