

EXECUTIVE COMPENSATION RECOVERY (CLAWBACK) RULES FAQs

A. Approach

Why are these implemented as NYSE and Nasdaq listing standards and not just SEC rules?

Section 954 of the Dodd-Frank Act added Section 10D to the Securities Exchange Act of 1934 (the “Exchange Act”). Section 10D(a) requires the Securities and Exchange Commission (the “SEC”) to adopt rules directing the national securities exchanges and associations to prohibit the listing of any security of an issuer that is not in compliance with the requirements of Section 10D(b). Section 10D(b) requires the SEC to adopt rules directing the exchanges to establish listing standards that require each issuer to develop and implement a policy providing that, in the event that the issuer is required to prepare an accounting restatement due to the issuer’s material noncompliance with any financial reporting requirement under the securities laws, the issuer will recover from any of the issuer’s current or former executive officers incentive-based compensation (including stock options awarded as compensation) that was received during the three-year period preceding the date the issuer is required to prepare the accounting restatement in excess of what would have been paid to the executive officer under the accounting restatement. Issuers must also publicly file the policy as an exhibit to the issuer’s Annual Report on Form 10-K and make certain required disclosures regarding the policy.

What are the consequences for not complying?

Being delisted.

B. Effective Dates

When will the final rules become effective?

The listing standards will be effective on December 1, 2023. Each listed issuer must adopt a compliant compensation recovery policy (a “Clawback Policy”) no later than December 1, 2023. The Clawback Policy must apply to incentive compensation received after the later of October 2, 2023 or the date the issuer becomes a listed company.

What is the first filing that must include a copy of the issuer’s Clawback Policy?

Listed companies must file a copy of the Clawback Policy as an exhibit to their Annual Report on Form 10-K beginning for fiscal years ending after December 1, 2023.

C. What are the Core Provisions of the Rules?

1. Mandatory Executive Compensation Clawback Policy

Listed companies must adopt and enforce a Clawback Policy that contains the following provisions:

- Provides for the recovery of incentive-based compensation received by current or former executive officers based on any misstated financial reporting measure if the company is required to prepare an accounting restatement.
- Provides for recovery of the amount of pre-tax incentive-based compensation received during the three-year period preceding the date the company is required to prepare the accounting restatement that exceeds the amount that would have been received based on the restated financial reporting measure, subject to very limited exceptions for instances in which recovery would be impracticable.
- For incentive-based compensation based on stock price or total shareholder return, which must be covered by the Clawback Policy, the amount of compensation to be recovered must be based on a reasonable estimate of the effect of the accounting restatement on the stock price or total shareholder return upon which the incentive-based compensation was received.

Listed companies that do not adopt and comply with these new listing standards will be subject to delisting.

2. Disclosures re Restatements and Application of Clawback Policy

The rules add new Item 402(w) to Regulation S-K, which will require each listed company to provide disclosures about its Clawback Policy and how it has applied the policy. The disclosure required by Item 402(w), including the disclosures discussed below, will be required in the company's annual report and in its proxy or information statements that call for Item 402 disclosure, and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 unless the company specifically incorporates it by reference. The rules will require companies to tag disclosures relating to recovery policies using Inline XBRL.

Key disclosure requirements:

- Annual Report: two new check boxes on the cover page of Form 10-K, 20-F and 40-F annual reports. The first check box will indicate whether the financial statements included in the filing reflect a correction of an error to previously issued financial statements. The second check box will indicate whether any of these corrections were restatements that triggered a compensation recovery analysis during the fiscal year.
- Filing of Compensation Recovery Policy: Each listed company must file its Clawback Policy as an exhibit to its annual report.
- Accounting Restatement Disclosures in Annual Report: If at any time during the last completed fiscal year the company was required to prepare an accounting restatement that required recovery of erroneously awarded compensation under a Clawback Policy, or if there was an outstanding balance as of the end of the last fiscal year of erroneously awarded compensation to be recovered pursuant to the Clawback Policy, Item 402(w) will require disclosure of:
 - The date on which the company was required to prepare an accounting restatement;
 - The aggregate dollar amount of erroneously awarded compensation attributable to the accounting restatement;
 - An analysis of how the amount was calculated;

- If the financial reporting measure related to stock price or a total shareholder return metric, the estimates that were used in determining the amount of the erroneously awarded compensation attributable to the accounting restatement and an explanation of the methodology used for these estimates;
- The aggregate recoverable dollar amount that remains outstanding at the end of the last completed fiscal year;
- Any outstanding amounts due from a current or former named executive officer for 180 days or more; and
- If recovery would be impracticable, the amount of recovery forgone and a brief description of the reason the company decided not to pursue recovery.

If at any time after its last completed fiscal year the company was required to prepare a financial restatement, and the company concluded that recovery was not required under the company's Clawback Policy, Item 402(w) requires a brief explanation of why application of the Clawback Policy resulted in that conclusion.

- D. Summary Compensation Table:** The rules added a new instruction to the Summary Compensation Table that will require companies to reduce the amount reported in the applicable column(s) of the Summary Compensation Table, as well as the "total" column of the Summary Compensation Table, for the fiscal year in which the amount recovered initially was reported as compensation to reflect the recovery of any amounts under the company's Clawback Policy and identify these amounts in a footnote to the Summary Compensation Table.

E. Companies Subject to the Rules

What companies are subject to the rules?

All exchange listed companies are subject to the final rules, with very limited exceptions for issuers of certain futures products, standardized options and unit investment trusts and registered investment companies. There are no exclusions for emerging growth companies ("EGCs"), smaller reporting companies ("SRCs"), or foreign private issuers ("FPIs").

Also covered: private companies that have listed debt or preferred securities and investment companies with exchange-listed securities other than 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 the fund's initial listing, if later).

How do the final rules apply to newly listed companies?

The final rules require a company to comply with Rule 10D-1 in order to meet initial listing requirements (i.e. companies that become listed on or after December 1, 2023 are generally required to adopt a clawback policy that complies with the requirements of Rule 10D-1 prior to listing).

F. Executives Subject to the Rules

What executives are subject to the rules?

The rules apply to “executive officers,” which is defined as a company’s president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president in charge of a principal business unit or function (e.g., sales, administration or finance), any other officer of the company who performs a policy-making function, and any other person who performs similar policy-making functions for the company, which is consistent with the definition of “officer” in Rule 16a-1(f) of the Exchange Act.

Does this apply to an executive officer but not involved in financial reporting such as a Chief Human Resources Officer, Chief Marketing Officer or Chief Medical Officer?

Yes. The final rules do not require that an executive officer had a direct role in financial reporting, was directly involved with the accounting error, or engaged in any misconduct.

How does this apply to FPIs that do not have Section 16 officers?

FPIs will need to identify their “executive officers” as defined in Rule 10D-1 and the final NYSE and Nasdaq rules and, therefore, subject to potential incentive compensation clawbacks. This group is likely to be a different group of officers than those identified by an FPI as “senior management” in Item 1 of Part I of Form 20-F.

What if a person becomes – or ceases to be – an executive officer in the middle of a period covered by a restatement?

The NYSE and Nasdaq rules require Clawback Policies to apply to all erroneously awarded incentive-based compensation received by a person (see below for a discussion of when compensation is deemed received):

- After that person begins service as an executive officer;
- Who served as an executive officer at any time during the performance period for that incentive-based compensation;
- While the company has a class of securities listed on an exchange; and
- During the three completed fiscal years immediately preceding the date that the company is required to prepare an accounting restatement that is subject to the final rules.

Awards of incentive-based compensation granted to a person before that person becomes an executive officer must be subject to the Clawback Policy if the person serves as an executive officer at any time during the performance period for that incentive-based compensation and the compensation is “received” after the person began service as an executive officer.

G. Compensation Subject to the Rules

Under the rules, clawback policies must require the recovery of erroneously awarded “**incentive-based compensation**” which is defined as any compensation that is granted, earned, or vested based wholly or in part on the attainment of any “**financial reporting measure.**”

What does “incentive-based compensation” include?

Incentive-based compensation that is subject to clawback includes any compensation that an executive officer would not have been entitled to receive had the financial statements been accurately presented.

The SEC adopted a principles-based definition that is intended to capture new forms of compensation that are developed and new measures of performance upon which compensation may be based.

Because the definition of incentive-based compensation includes compensation earned “in part” upon achieving a financial reporting measure, incentive-based compensation includes compensation that is not tied to a financial reporting measure in a strictly formulaic manner. This would include discretionary bonuses paid from a bonus pool, where the size of the pool is determined based wholly or in part on the attainment of a financial reporting measure, or awards that are earned based on the attainment of a financial reporting measure that are subject to discretionary increase or decrease.

The adopting release also included several examples of types of compensation that are not incentive-based compensation, including, among others:

- Salaries, except to the extent a salary increase is earned wholly or in part based on the attainment of a financial reporting measure performance goal;
- Discretionary bonuses that are not paid from a bonus pool that is determined by satisfying a financial reporting measure performance goal; and
- Equity awards for which neither the grant nor vesting is contingent upon achieving a financial reporting measure performance goal (e.g., stock options or restricted stock units subject solely to time-based vesting that were not granted based on the achievement of a financial reporting metric would not be incentive-based compensation under the final rules regardless of when they were exercised).

What constitutes a financial reporting measure?

A “financial reporting measure” is one that is determined and presented in accordance with the accounting principles used in preparing the company’s financial statements and measures derived from such measures. A company’s stock price and total shareholder return are expressly identified as financial reporting measures in the rules.

- A “financial reporting measure” includes non-GAAP financial measures as defined in Regulation G and Item 10(e) of Regulation S-K, but also includes measures and ratios that are neither GAAP financial measures nor non-GAAP financial measures.
- The adopting release includes a non-exhaustive list of examples, including, among many others, measures such as accounts receivable turnover and other ratios, sales per square foot or same store sales (if sales is subject to an accounting restatement), revenue per user (if revenue is subject to an accounting restatement), cost per employee (if cost is subject to an accounting restatement), and any financial reporting measures relative to a peer group (if the company’s financial reporting measure is subject to an accounting restatement).
- The definition of financial reporting measure does not require that a measure be presented in the company’s financial statements or included in an SEC filing.

H. What Kind of Restatement is Covered by the Rules?

Both “Big R” and “little r” restatements trigger applicability of the recovery requirement.

- A Big R restatement involves correcting an error was material to previously issued financial statements; the error is so significant that prior period financial statements are reissued and a Form 8-K is filed.
- A little r restatement involves correcting an error that would be material to the current period financial statements if left uncorrected or if the correction were recorded only in the current period. Due to the materiality of the impact of the error on the current period, the previously issued financial statements must be revised to correct it even though the error may not have been material to those financial statements; these are corrected through a revision that corrects errors in the current year's comparative financial statements

I. What Amount of Compensation is Subject to Recovery under the Rules?

How is the amount of excess compensation determined?

Rule 10D-1 and the NYSE and Nasdaq rules mandate that a company's Clawback Policy require recovery of the amount of incentive-based compensation received that exceeds the amount of incentive-based compensation that otherwise would have been received had it been determined based on the restated financial statements, without adjustment for any taxes paid on the compensation.

To the extent that the amount of erroneously awarded compensation is based on the company's stock price or total shareholder return, the amount of erroneously awarded compensation may be calculated based on a reasonable estimate of the effect of the restatement on the stock price or total shareholder return upon which the compensation was received.

Wait, what? Without adjustment for any taxes already paid on compensation?

That's correct. The rules mandate that erroneously awarded compensation must be calculated without respect to tax liabilities that may have been incurred or paid by the executive to ensure, in the SEC's view, that the issuer recovers the full amount of incentive-based compensation that was erroneously awarded.

The SEC states in the issuing release that recovery on a pre-tax basis permits the issuer to avoid the burden and administrative costs associated with calculating erroneously awarded compensation based on the particular tax circumstances of individual executive officers, which may vary significantly based on factors independent of the incentive-based compensation and outside of the issuer's control.

The SEC notes that the ability of executive officers to recoup, to the extent authorized by applicable tax laws and regulations, taxes previously paid on recovered compensation mitigates fairness concerns, and opines that the resulting tax burden should be borne by executive officers, not the issuer and its shareholders.

When is incentive compensation considered "received?"

Compensation will be deemed "received" for purposes of the rules in the fiscal period during which the financial reporting measure specified in the incentive-based compensation award is attained, even if the payment or grant occurs after the end of that period.

- For example, an equity award that is earned based on the company's total shareholder return for the three-year period ending December 31, 2024 would be deemed received in 2024 even though

the shares are not issued until early 2025, and even if the shares are subject to additional time-based vesting. As a result, the shares would be subject to potential clawback if the company was required to prepare an accounting restatement in 2025, 2026 or 2027.

The Clawback Policy must require the recovery of incentive-based compensation that is received while the company has a class of securities listed on an exchange. This means that incentive-based compensation “received” prior to a company’s IPO need not be subject to the policy even if was received in the three-year clawback period.

J. Fiscal Years Covered by Application of the Rules

How many years of compensation are subject to recovery?

Clawbacks Policies must apply to incentive-based compensation received during the three completed fiscal years immediately preceding the date the company is required to prepare an accounting restatement, plus any transition periods related to a change in fiscal years. The final rules do not require the policy to apply to incentive-based compensation received during the partial year period between the date the company is required to prepare an accounting restatement and the end of the prior fiscal year.

For example, if a company with a calendar year end fiscal year concludes in November 2024 that a restatement of previously issued financial statements is required and files the restated financial statements in January 2025, the final rules require the policy to apply to incentive-based compensation received in 2021, 2022, and 2023.

What is the applicable date for determining when a restatement is required for purposes of the look back?

The date that an issuer is required to prepare an accounting restatement as described in Rule 10D-1 and the NYSE and Nasdaq rules is the earlier to occur of:

- The date the issuer’s board of directors, a committee of the board of directors, or the officer or officers of the issuer authorized to take such action if board action is not required, concludes, or reasonably should have concluded, that the issuer is required to prepare an accounting restatement; or
- The date a court, regulator, or other legally authorized body directs the issuer to prepare an accounting restatement.

What about pre-IPO periods?

Rule 10D-1 and the NYSE and Nasdaq rules mandate that Clawback Policies must require the recovery of incentive-based compensation that is received while the company has a class of securities listed on an exchange. This means that, unless an issuer goes beyond the requirements of the rules, incentive-based compensation received prior to a company’s IPO need not be subject to the policy even if it otherwise would have been in the three-year clawback period.

K. Company Enforcement of the Policy

How does the company need to go about collecting the required recovery amounts?

The rules are not prescriptive.

Companies have discretion on means of recovery; however, the recovery must be done reasonably promptly. Companies are not permitted to settle for less than the full amount unless conditions demonstrating that recovery is impracticable are fulfilled.

Are there exceptions to the recovery requirement?

Yes, but they are quite limited. A company must recover erroneously awarded compensation in compliance its Clawback Policies unless the company's committee of independent directors responsible for executive compensation decisions, or in the absence of such a committee, a majority of the independent directors serving on the board, has made a determination that recovery would be impracticable and one of the following conditions is met:

- Recovery would likely cause an otherwise tax-qualified retirement plan to fail to meet the requirements of the Internal Revenue Code;
- The direct expense paid to a third party to assist in enforcing the policy would exceed the amount to be recovered (cannot take into account other indirect costs); or
- For issuers incorporated outside the U.S., recovery would violate a home country law adopted prior to November 28, 2023 if the issuer provides to the NYSE or Nasdaq an opinion of home country counsel to that effect.

Before concluding that it would be impracticable to recover any amount of erroneously awarded compensation based on expense of enforcement, the company must make a reasonable attempt to recover such erroneously awarded compensation, document such reasonable attempt(s) to recover, and provide that documentation to the listing exchange.

Does a company need to disclose publicly that it hasn't been able to recover amounts?

Yes. If the Company is relying on impracticability exceptions, it must include in its annual reports and in its proxy or information statements that call for Item 402 disclosure, for each current and former named executive officer and for all other current and former executive officers as a group, the amount of recovery forgone and a brief description of the reason recovery was not pursued (such as expenses paid to a third party).

In addition, companies must disclose in its annual reports and in its proxy or information statements that call for Item 402 disclosure:

- The aggregate dollar amount of erroneously awarded compensation that remains outstanding at the end of the last completed fiscal year; and
- For each current and former named executive officer from whom erroneously awarded compensation had been outstanding for 180 days or longer since the date the company determined the amount subject to recover, the dollar amount of outstanding erroneously awarded compensation due from each such individual.

Should we be updating employment agreements and/or equity award agreements to include an acknowledgement of the clawback policy? Should companies require covered employees to sign a separate acknowledgement of the clawback policy?

In our view, it is unlikely that a standalone acknowledgement would be enforceable without some consideration beyond continued employment. Clients should consider including clawback provisions in go-forward equity award agreements (but that apply to all incentive compensation) and go-forward employment agreements.

Can the Company reimburse the executive for the amount recovered?

No. The final rules prohibit companies from indemnifying any executive officer or former executive officer against loss of erroneously-awarded compensation. In the adopting release, the SEC stated that it views this requirement as also prohibiting companies from paying for or reimbursing a current or former executive officer for the cost of any third-party insurance policy intended to fund potential recovery obligations or modifying current compensation arrangements or taking other actions that would amount to de facto indemnification, such as by providing an executive officer a new cash award which the issuer would then “cancel” to effect recovery of outstanding recoverable amounts.

L. Inline XBRL

Do Inline XBRL requirements apply to the new disclosures?

Yes. The final rules will require companies to tag disclosures relating to recovery policies using Inline XBRL.

M. Broader Clawback Policies

Should my clawback policy go beyond the Rule 10D-1 and NYSE/Nasdaq requirements?

Ultimately, this is a business decision and may depend on the importance of the views of institutional investors and proxy advisory firms for the company as well as the terms of any existing compensation recovery adopted by the company.

If a company wants to adopt a clawback policy that goes beyond the rule requirements, should it adopt two separate clawback policies?

Some compensation consultants are suggesting companies adopt two separate policies – (1) one tailored to the rule requirements and (2) a broader, potentially discretionary, policy that applies to employees beyond Section 16 officers and/or incorporates additional potential triggers beyond restatements. Two policies allows the company to avoid additional disclosures and the second policy would not need to be publicly filed. However, companies wanting credit from ISS and Glass Lewis would need to include publicly disclosure describing this additional policy.

We are not seeing a lot of companies doing taking this approach at this point.

N. Links

Final Rules:

Final rules: [Listing Standards for Recovery of Erroneously Awarded Compensation](#), Release No. 33-11126 (October 26, 2022)

Fact sheet: [Recovery of Erroneously Awarded Compensation](#) (October 26, 2022)

Press release: [SEC Adopts Pay Versus Performance Disclosure Rules](#) (2022-192, October 26, 2022)

NYSE Listing Standard:

SEC SRO filing: [Listing Standards Related to Recovery of Erroneously Awarded Incentive-Based Executive Compensation](#), Release No. 34-97688 (June 9, 2023)

Nasdaq Listing Standard:

SEC SRO filing: [Listing Standards Related to Recovery of Erroneously Awarded Executive Compensation](#), Release No. 34-97287 (June 9, 2023)

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