



SEC Clawback Rules Finalized

Implications for Companies With or Without Existing Policies

Clawback rules for the recovery of erroneously awarded compensation were adopted by the U.S. Securities and Exchange Commission on October 26, 2022, by a 3-2 vote. The rules stem from the 2010 Dodd-Frank Act, which added a new Section 10D to the Securities Exchange Act of 1934. These rules direct the SEC to require national securities exchanges to enact standards that obligate listed companies to adopt and disclose clawback policies. While the SEC originally proposed its rules in 2015, progress had stalled until comment periods reopened in 2021 and 2022.

The final rules mean that listed companies will be required to adopt and disclose policies that recover incentive compensation from current and former executive officers upon a financial restatement due to material noncompliance with reporting requirements.

Upon release of the final rules, SEC Chair Gary Gensler said in a statement that he believes “these rules will strengthen the transparency and quality of corporate financial statements, investor confidence in those statements, and the accountability of corporate executives to investors.” Gensler also noted that by adopting final clawback rules and working with the securities exchanges, the SEC has “the opportunity to fulfill Dodd-Frank’s mandate and Congress’s intention to prevent executives from keeping compensation received based on misstated financials.”

In voting against the rules, SEC Commissioner Hester Pierce said, “The release before us adopts a

prescriptive approach that, because of its breadth and inflexibility, in some cases, could impose costs on shareholders greater than the benefits they derive from the clawbacks.”

Considerations for Companies

Most companies, including some 95% of S&P 500 companies and nearly 60% of Russell 3000 companies (excluding S&P 500 companies), already have some type of voluntary clawback policy. The existing voluntary clawback policies vary widely from the minimum possible to highly stringent standards, such as clawbacks that recoup all compensation for cases of employee misconduct. As such, to address the new SEC clawback rules, companies will need to review each element of their existing clawback policies and determine where and how modification will be necessary.

Companies that have existing elements that go above and beyond the SEC rules will likely maintain those. Shareholders will not want to see existing policies weakened to meet the minimums of the SEC rules. Additionally, institutional investors and proxy advisors increasingly expect to see “enhanced clawbacks” that extend beyond the rule; those expectations are unlikely to go away.

Since the 2015 SEC proposal, many companies have adopted clawback policies reflective of the original proposed SEC rules—for these companies, adhering to the rule will be a simpler matter of reviewing existing

clauses and making minor modifications to reflect the final requirements. For instance, many companies that had maintained wide board discretion to determine whether and how to proceed with a clawback when a restatement occurred will need to eliminate board discretion except for narrow cases defined by the rules.

When assessing existing policies versus the rules, companies should list each individual element of their clawback policy, compare it against the SEC rules, and then determine how to proceed in making the necessary changes. Below is a summary of common elements for voluntary clawbacks from the lowest to highest standards as compared to the final SEC rules.

Summary of Common Existing Clawback Elements vs. the Final SEC Clawback Rules

CLAWBACK ELEMENT	COMMON PRACTICE FOR VOLUNTARY CLAWBACKS		FINAL SEC RULE
	LOWEST STANDARDS	HIGHEST STANDARDS	
Trigger	<ul style="list-style-type: none"> Restatement due to fraud/misconduct 	<ul style="list-style-type: none"> Any detrimental activity causing reputational harm 	Any restatement due to material noncompliance regardless of fault, fraud, or misconduct ¹
Covered Individuals	<ul style="list-style-type: none"> CEO 	<ul style="list-style-type: none"> All employees 	Current and former Section 16 Officers
Covered Period/ Lookback	<ul style="list-style-type: none"> One year 	<ul style="list-style-type: none"> Indefinite 	Three fiscal years preceding the date on which a restatement is required
Compensation Subject to Clawback	<ul style="list-style-type: none"> Annual bonus only 	<ul style="list-style-type: none"> All compensation, including time-based equity awards 	Incentive-based compensation granted, earned, or vested based wholly or in part on the attainment of any “financial reporting measures”
Clawback Amount	<ul style="list-style-type: none"> Excess amount tied to restatement 	<ul style="list-style-type: none"> Up to 100% of paid and unvested compensation (excluding salaries) 	Amount more than incentive-based compensation that would have been paid under the restatement
Board Discretion	<ul style="list-style-type: none"> Discretion to determine whether and how to proceed with clawback 	<ul style="list-style-type: none"> No board discretion 	Discretion limited to where the cost of recovery exceeds the recoverable amounts, or recovery would violate home country law
Disclosure	<ul style="list-style-type: none"> Summarize policy in CD&A 	<ul style="list-style-type: none"> Summarize policy and report clawback activity 	Report in 10-K Indication of whether restatements are required or underwent analysis Indication of whether a clawback was triggered or recoverable amount is outstanding

¹Also applies to restatements that correct errors not material to previously issued financial statements but could result in material misstatement if left uncorrected in current financial results



Finally, for companies with no existing clawback policy in place, now is a good time to not only adopt the required rules but also review the potential for enhanced clawbacks. Institutional investors are increasingly interested in seeing enhanced clawbacks that may include reputational harm, data security breaches, sexual harassment, and violations of non-compete or non-solicitation agreements. Additionally, proxy advisors evaluate clawback policies as part of their Say-on-Pay and equity plan assessments, and they have expectations for enhanced provisions. Ultimately, the final clawback rules will serve as the minimum requirements moving forward upon which companies can enhance or expand if they so choose.

Action Items

Given the timing requirements, we can expect stock exchanges to propose listing standards with these new rules by January 24, 2023, with effective dates no later than October 2023. As such, public companies must evaluate their clawback policies in early 2023 and be prepared to adopt and implement such policies by October 2023. Key action steps include:

- Review existing clawback policies, if any, to determine how to integrate the requirements of the SEC rules into existing policies or replace existing policies with the SEC's rules
- Add reviews of the clawback policy and potential changes to compensation committee agendas
- Review incentive plan documents to identify potential amendments that add relevant details on when and how compensation amounts may be recouped
- Evaluate incentive plan compensation arrangements to determine how clawback scenarios would play out
 - Under the SEC rules, certain incentive plan types, such as those with a mix of financial and non-financial metrics, or which use TSR-based measures, or which are determined based off a bonus pool, may require greater effort to determine erroneously awarded compensation
- Prepare for communication of clawback policies internally and externally
- Prepare for disclosure of the clawback policy and clawback activity in annual reports (10-Ks for US companies) and proxy statements



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