

Recovery of Erroneously Awarded Compensation



The Securities and Exchange Commission will consider adopting final rules requiring the recovery of erroneously awarded compensation as required by Congress in the Dodd-Frank Act.

The rules would, among other things, require national securities exchanges to establish listing standards that would require listed issuers to adopt and comply with a compensation recovery policy, often known as a clawback policy, and require listed issuers to provide disclosure about such policies and how they are being implemented.

Background

The Dodd-Frank Wall Street Reform and Consumer Protection Act added Section 10D to the Securities Exchange Act of 1934. Section 10D requires the SEC to direct the national securities exchanges and associations that list securities to establish listing standards that require each issuer to develop and implement a clawback policy. That policy must provide that, in the event the issuer is required to prepare an accounting restatement, the issuer will recover incentive-based compensation paid to its current or former executive officers based on any misstated financial reporting measure. The policy must apply to compensation received during the three-year period preceding the date the issuer is required to prepare the accounting restatement.

In July 2015, the SEC proposed rules and rule amendments to implement the recovery of erroneously awarded compensation requirement. In October 2021 and again in June 2022, the SEC reopened the comment period for the 2015 proposed rules and provided the public with the opportunity to comment further and address certain additional requirements the Commission was considering in connection with the proposed rule.

What's Required

New Rule 10D-1 would require exchanges to adopt listing standards that will apply the disclosure and compensation recovery policy requirements to all listed issuers, with only limited exceptions. Each listed issuer would be required to adopt a compensation recovery policy, comply with that policy, and provide the required compensation recovery policy disclosures. An issuer would be subject to delisting if it does not adopt and comply with a compensation recovery policy that meets the requirements of the listing standards.

Under the new rule, if an issuer is required to prepare an accounting restatement, including to correct an error that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period, the issuer would be required to recover from any current or former executive officers incentive-based compensation that was erroneously awarded during the three years preceding the date such a restatement was required. The recoverable amount is the amount of incentive-based compensation received in excess of the amount that otherwise would have been received had it been determined based on the restated financial measure.

The listing standards would require an issuer to recover erroneously awarded compensation, subject to limited impracticability exceptions available only in circumstances where:

- Direct expenses paid to third parties to assist in enforcing the policy would exceed the amount to be recovered and the issuer has made a reasonable attempt to recover;
- Recovery would violate home country law that existed at the time of adoption of the rule, and the issuer provides an opinion of counsel to that effect to the exchange; or
- Recovery would likely cause an otherwise tax-qualified retirement plan to fail to meet the requirements of the Internal Revenue Code.

The Commission will also consider adopting amendments to Item 402 of Regulation S-K, Form 40-F, and Form 20-F (and for listed funds, Form N-CSR) to include new disclosure requirements related to the required policies. Under the new rules, a listed issuer would be required to file its policy as an exhibit to its annual report and disclose how it has applied the policy, including, as relevant: (1) The date it was required to prepare an accounting restatement and the aggregate dollar amount of erroneously awarded compensation attributable to such accounting restatement (including the estimates used in calculating the recoverable amount in the case of awards based on stock price or total shareholder return); (2) the aggregate amount that remains outstanding and any outstanding amounts due from any current or former named executive officer for 180 days or more; and (3) details regarding any reliance on the impracticability exceptions. Issuers will be required to use Inline XBRL to tag their compensation recovery disclosure.

What's Next

The rules and amendments, if adopted, will become effective 60 days following publication of the release in the Federal Register. Exchanges would be required to file proposed listing standards no later than 90 days following publication of the release in the Federal Register, and the listing standards would be required to be effective no later than one year following such publication. Issuers subject to such listing standards would be required to adopt a recovery policy no later than 60 days following the date on which the applicable listing standards become effective and must begin to comply with these disclosure requirements in proxy and information statements and the issuer's annual report filed on or after the issuer adopts its recovery policy.