

Legal Update

Compensation Clawback Listing Standards Requirement: US Securities and Exchange Commission Adopts Final Rules

On October 26, 2022, the US Securities and Exchange Commission (SEC) adopted new Rule 10D-1, directing national securities exchanges to establish listing standards that prohibit the listing of any security of a company that does not adopt and implement a written policy requiring the recovery, or “clawback,” of certain incentive-based executive compensation.¹ Recovery under a clawback policy must be the amount of incentive compensation that is shown to have been paid in error, based on an accounting restatement that is necessary to correct a material error of a financial reporting requirement.

In a significant expansion of the rule as originally proposed, Rule 10D-1 will require the recovery policy to apply to any accounting restatement to correct not only an error in previously issued financial statements that is material to the previously issued financial statements (also called a “Big R” restatement) but also 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 (also called a “little r” restatement).

If a current or former executive officer received erroneously awarded incentive-based compensation within the three fiscal years preceding the date of determination that a restatement is required, the company must recover the excess incentive-based compensation on a “no-fault” basis. The rule also specifies disclosure requirements under newly created Item 402(w) relating to clawback policies and clawbacks.

Background

Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) added Section 10D to the Securities Exchange Act of 1934, requiring the SEC to direct national securities exchanges to establish listing standards that prohibit the listing of any security of a company that does not adopt and implement a written policy requiring the recovery, or “clawback,” of certain incentive-based executive compensation payments.

The Dodd-Frank Act clawback requirement set forth in Section 10D contains key differences from the clawback requirement that was implemented by Section 304 of the Sarbanes Oxley Act of 2002 (Sarbanes-Oxley Act). For example, the Dodd-Frank Act requirement applies to all current and former executive officers while the Sarbanes-Oxley Act provision applies only to the chief executive officer and the chief financial officer. In addition, the Dodd-Frank Act requirement applies to any accounting restatement that is due to material noncompliance, whether or not there is misconduct, while the Sarbanes-Oxley Act requirement applies only to

accounting restatements resulting from misconduct. The SEC first proposed rules setting forth the Dodd-Frank Act clawback requirements in 2015 (2015 Proposal); however, the 2015 Proposal was never adopted. On October 14, 2021, the SEC issued a release reopening the 2015 Proposal (Reopening Release). Developments in clawback policies since 2015 provided an impetus for the SEC to reopen the comment period. In particular, the Reopening Release noted “an increase in the number of companies disclosing information about their ability to recoup performance-based awards in the event of fraud, restatement of financial statements, or other reasons, and adopting and implementing executive compensation clawback policies addressing these circumstances.” (See our October 18, 2021, Legal Update “[SEC Reopens Comment Period for Clawback Listing Standard.](#)”)

Mandated Listing Standards

Incentive-Based Compensation. Rule 10D-1 defines incentive-based compensation as any compensation that is granted, earned, or vested based wholly or in part upon the attainment of any financial reporting measure. For this purpose, the term “financial reporting measures” means measures that are determined and presented in accordance with the accounting principles used in preparing the company’s financial statements, and any measures derived wholly or in part from such financial information (such as non-GAAP financial measures). Additionally, Rule 10D-1 specifically adds stock price and total shareholder return as financial reporting measures for purposes of this rule. The definition is drafted to cover any new forms of compensation and new performance measures that may arise in the future to determine or award incentive-based compensation.

The adopting release includes the same examples of compensation that would, and would not, constitute incentive-based compensation as included in the 2015 Proposal. The following are non-exclusive examples of compensation that would constitute incentive-based compensation:

- Non-equity incentive plan awards that are earned based wholly or in part on satisfying a financial reporting measure performance goal;
- Bonuses paid from a “bonus pool,” the size of which is determined based wholly or in part on satisfying a financial reporting measure performance goal;
- Other cash awards based on satisfaction of a financial reporting measure performance goal;
- Restricted stock, restricted stock units, performance share units, stock options, and stock appreciation rights (SARs) that are granted or become vested based wholly or in part on satisfying a financial reporting measure performance goal; and
- Proceeds received upon the sale of shares acquired through an incentive plan that were granted or vested based wholly or in part on satisfying a financial reporting measure performance goal.

The following are non-exclusive examples of compensation that would not constitute incentive-based compensation:

- Salaries;
- Discretionary compensation, if it is not paid as part of a bonus pool that is based wholly or in part on a financial reporting measure performance goal;
- Bonuses based on subjective standards and/or completion of a specified period of employment;
- Non-equity incentive plan awards earned solely upon satisfying strategic or operational measures; and
- Equity awards where the grant is not contingent upon achieving any financial reporting measure performance goal and where vesting is contingent solely upon completion of a specified employment period and/or attaining non-financial reporting measures.

Amount Recoverable. The amount that listed companies would have to recover is the amount of incentive-based compensation received by the executive officer or former executive officer that exceeds the amount of incentive-based compensation that otherwise would have been received had it been determined based on the accounting restatement. Amounts recovered are computed without regard to taxes that may have been paid or incurred by the executive officer.

To calculate the amount of the excess after an accounting restatement, the company would first need to recalculate both the applicable financial reporting measure and the amount of incentive-based compensation that was based on this measure. Next the company would have to determine whether the executive officer received a greater amount of incentive-based compensation based on the original calculation of the financial reporting measure than such officer would have received based on the recalculated financial reporting measure, after taking into account any discretion applied by the compensation committee to reduce the amount received. If the compensation was only partially based on the financial reporting measure performance goal, the company would need to determine the portion of the original compensation that was based on or derived from the restated financial measure. The company would then have to recalculate the affected portion to determine the excess amount to be recovered.

Because incentive-based compensation that is based on stock price or total shareholder return is not subject to mathematical recalculation directly from the information in an accounting restatement, Rule 10D-1 permits companies to determine the recoverable amount based on a reasonable estimate of the effect of the accounting restatement on stock price or total shareholder return, as applicable, in such circumstances. When this occurs, the listed company must retain documentation of that estimate determination and provide it to the exchange.

Recovery Mechanics. With respect to recoverable incentive-based compensation, the recovery mechanics will depend on the form in which the executive officer holds such compensation at the time of recovery. The adopting release notes that the definition of erroneously awarded compensation is intended to be applied in a principles-based manner thereby allowing companies to adopt a more rigorous recovery policy, provided the minimum requirements set forth in the rules are satisfied. The adopting release provided examples of how to calculate the recovery of certain types of incentive compensation:

- For cash awards, the erroneously awarded compensation is the difference between the amount of the cash award (whether payable as a lump sum or over time) that was received and the amount that should have been received applying the restated financial reporting measure;
- For nonqualified deferred compensation, the executive officer's account balance or distributions would be reduced by the erroneously awarded compensation contributed to the nonqualified deferred compensation plan and the interest or other earnings accrued thereon under the nonqualified deferred compensation plan;
- 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; and
- 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).

The SEC declined to provide additional guidance on recovery for other forms of incentive-based compensation, suggesting that those determinations will be made based on the individual facts and circumstances of the terms of the incentive compensation arrangements between the company and its executive officer.

If the same compensation is recouped pursuant to Section 304 of the Sarbanes-Oxley Act or other recovery provisions, such payment would reduce the amounts recoverable under the listing standards.

Employees Covered. Rule 10D-1 as adopted applies to any individual who, after beginning service as an executive officer, served as an executive officer of the listed company at any time during the performance period for that incentive-based compensation, whether or not such individual is an executive officer at the time the company is seeking recovery. The clawback is not limited to named executive officers (i.e., those executive officers whose compensation is described in the company's proxy statement). Furthermore, the clawback is not limited to executive officers who engaged in misconduct or were directly involved with the accounting error.

Rule 10D-1 defines executive officer as the company's "president, principal financial officer, principal accounting officer (or if there is no such accounting officer, the controller), any vice-president of the company 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 company]."

These specified officers would be subject to the clawback policy, even if the company does not otherwise treat any such individuals as an executive officer for any other purpose. Officers of the company's parents or subsidiaries will be deemed to be executive officers of the company if they perform such policy-making functions for the company. The SEC modeled this definition on the definition of "officer" for the purposes of Section 16 of the Exchange Act and also include any individual identified by the company as an executive officer in the Company's Form 10-K.

Restatements. Rule 10D-1 requires a clawback of incentive-based compensation when a listed company is required to prepare an accounting restatement due to the material noncompliance of the company with any financial reporting requirement under the securities laws, including any required accounting restatement to correct an error (1) in previously issued financial statements that is material to the previously issued financial statements; or (2) that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period.

The rules as adopted consider both "Big R" and "little r" restatements to be within the scope of the recovery policy contemplated by Congress because "both result in revisions of previously issued financial statements for a correction of an error in those financial statements."

The rules as adopted do not define "accounting restatement" or "material noncompliance." Existing accounting standards and guidance already provide meanings for both terms.

The following types of financial statement changes are not considered corrections of errors and, therefore, would not trigger a clawback under Rule 10D-1:

- Retrospective application of a change in accounting principle;
- Retrospective revision to reportable segment information due to a change in the structure of an company's internal organization;
- Retrospective reclassification due to a discontinued operation;
- Retrospective application of a change in reporting entity, such as from a reorganization of entities under common control;

- Retrospective adjustment to provisional amounts in connection with a prior business combination (IFRS filers only); and
- Retrospective revision for stock splits, reverse stock splits, stock dividends, or other changes to capital structure.

Look-Back Period. Rule 10D-1 requires listed companies to recover incentive-based compensation received during the three completed fiscal years immediately preceding the date that the company is required to prepare an accounting restatement, which is considered to occur for purposes of Rule 10D-1 on the earlier to occur of:

- The date the listed company's board of directors, board committee or authorized officer or officers concludes, or reasonably should have concluded, that the company is required to prepare an accounting restatement due to the material noncompliance of the company with any financial reporting requirement under the securities laws; or
- The date a court, regulator, or other legally authorized body directs the company to prepare an accounting restatement.

The adopting release provides the following example on the timing of the look-back period: if a company that reports on a calendar year basis concludes in November 2024 that a restatement of previously issued financial statements is required and files the restated financial statements in January 2025, the three-year look-back period would apply to compensation received in 2021, 2022, and 2023.

In arriving at a conclusion that an accounting restatement is required, the adopting release points out that while not dispositive, companies should carefully consider any notice from the company's independent auditors that previously issued financial statements contain a material error. The triggering event is the determination that an accounting restatement needs to be prepared, which may precede the determination of the actual amount of the error.

Incentive-based compensation would be deemed received in the fiscal period in which the financial reporting measure is attained, even if the payment or grant occurs in a subsequent fiscal period. When the officer's right to the incentive-based compensation is subject to multiple conditions, the award is deemed received for purposes of the clawback when the relevant financial reporting measure performance goal is attained, regardless of whether the executive officer has only a contingent right to payment.

The date of the receipt of the compensation varies depending on the terms of the award and the type of the award. The adopting release provides the following examples:

- If the grant of the award is based, either wholly or in part, on satisfaction of a financial reporting measure performance goal, the award would be deemed received in the fiscal period when that measure is satisfied;
- If an equity award vests only upon satisfaction of a financial reporting measure performance condition, the award would be deemed received in the fiscal period when it vests;
- A non-equity incentive plan award would be deemed received in the fiscal year that the executive officer earns the award based on the satisfaction of the relevant financial reporting measure performance goal rather than on a subsequent date on which the award was paid; and
- A cash award earned upon satisfaction of a financial reporting measure performance goal would be deemed received in the fiscal period when the measure is satisfied.

Ministerial acts, such as calculating the amount earned or certification of the attainment of the financial measure by the board or a board committee do not affect the determination of the date received. Incentive-

based compensation would be subject to recovery under Rule 10D-1 only if the executive officer receives such compensation while the company has a class of securities listed on an exchange.

Covered Companies. With very few exceptions, the clawback listing standards apply to all listed companies. This means that foreign private issuers, smaller reporting companies, emerging growth companies, business development companies, and companies that list only debt or preferred securities would be subject to the clawback listing standards to the extent that they have securities listed on a national securities exchange. Rule 10D-1 does not grant securities exchanges the discretion to exempt any categories of companies from the listing standards.

The exceptions from applicability of the clawback listing standards are very narrow in scope. A clearing agency that serves as the issuer for securities futures products or standardized options will not be subject to the rule. A registered investment management company would be exempt if it has not awarded incentive-based compensation to any of its executive officers in any of the last three fiscal years or, if the company has not been listed for three fiscal years, since its initial listing. Finally, securities issued by a unit investment trust are exempt from the clawback listing standards.

Mandatory Clawback. Rule 10D-1 mandates recovery of erroneously awarded compensation in compliance with a company's recovery policy except to the extent that pursuit of recovery would be impracticable. Despite the urging of commenters, the SEC did not provide a board of directors with very much latitude to exercise discretion. Rule 10D-1 allows for only three narrow exceptions where recovery is considered impractical: (1) the direct cost of recovery would exceed the amount of recovery, (2) the recovery would violate home country law and additional conditions are met and (3) potential disqualification of tax-qualified retirement plans.

First, listed companies do not have to recover excess incentive-based compensation if the direct expense of recouping the compensation would exceed the amount recoverable. However, to rely on this exception the company must first make a reasonable attempt to recover the requisite compensation and document the recovery efforts. To be deemed to be impracticable, the direct costs paid to a third party to assist in enforcing recovery, such as legal expenses and consulting fees, must exceed the erroneously awarded compensation amounts.

Second, a company does not need to seek recovery of excess incentive-based compensation if recovery of such compensation would violate home country law that was adopted prior to the date of publication of Rule 10D-1 in the *Federal Register*. Further, in order to rely on this exception, the company must first obtain an opinion of home country counsel, acceptable to the applicable exchange, that recovery would result in such a violation.

Finally, companies are not required to seek recovery from tax-qualified retirement plans if such recovery would likely cause the plans to fail to meet the statutory requirements for tax exemption. However, amounts contributed to plans limited only to executive officers, supplemental executive retirement plans, or other nonqualified plans and benefits therefrom, would still be subject to recovery.

For each of these exceptions, the determination would have to be made by a committee of independent directors that is responsible for executive compensation decisions, such as a compensation committee or, in the absence of such a committee, by a majority of the independent directors. In addition, as discussed below, the company would need to disclose why it did not pursue the recovery. The determination is subject to review by the applicable exchange.

Rule 10D-1 does allow companies to exercise discretion in how to accomplish recovery, recognizing that the means of recovery may vary by the type of compensation arrangement, as well as by company, provided that the recovery of excess incentive-based compensation must be pursued "reasonably promptly." However, the

rule does not provide a definition for “reasonably promptly,” noting that reasonableness may vary by the costs incident to recovery efforts.

Indemnification Prohibited. Listed companies are prohibited from indemnifying their executive officers for incentive compensation recoverable pursuant to clawback policies and from paying the premiums on any insurance policy protecting against such recoveries.

Non-Compliance. Under the rules as adopted, a company would be subject to delisting if it does not:

- Adopt a compensation recovery policy that complies with applicable listing standards;
- Comply with the policy’s recovery provisions; or
- Provide the required disclosures in accordance with SEC rules.

Disclosure Requirements

The rules require listed companies to: (1) file their clawback policies as exhibits to their annual reports on Form 10-K, Form 20-F or Form 40-F, as applicable; (2) make disclosures relating to their compliance with their compensation recovery policy; (3) provide the additional information in Inline XBRL; and (4) include additional check box disclosure on the cover of their Form 10-K, 20-F, or 40-F.

Additional Item 402 Disclosure. The SEC has adopted new subsection (w) to Item 402 of Regulation S-K, which requires disclosure in proxy and information statements if during or after its last completed fiscal year a listed company either (1) was required to prepare an accounting restatement that required a clawback under the company’s clawback policy or (2) had an outstanding balance of unrecovered excess incentive-based compensation relating to a prior restatement. In these circumstances, a listed company would be required to disclose:

- For each restatement:
 - The date on which the company was required to prepare an accounting restatement;
 - The aggregate dollar amount of erroneously awarded compensation resulting from the restatement (including an analysis of how the amount was calculated);
 - If the financial reporting measure that was restated related to stock price or total shareholder return, the estimates used to determine the erroneously awarded compensation attributable to the restatement and an explanation of the methodology used for such estimates;
 - The aggregate dollar amount of erroneously awarded compensation that remains outstanding at the end of the last completed fiscal year; and
 - If the aggregate dollar amount of erroneously awarded compensation has not yet been determined, disclosure of that fact and an explanation therefor, with the information required for each restatement required to be disclosed in the next filing that includes disclosure pursuant to Item 402 of Regulation S-K.
- If recovery would be impracticable, 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 the company decided in each case not to pursue recovery; and
- For each current and former named executive officer from whom, as of the end of the last completed fiscal year, erroneously awarded compensation had been outstanding for 180 days or longer since the date the company determined the amount the individual owed, the dollar amount of outstanding erroneously awarded compensation due from each such individual.

Any disclosure regarding impracticability of recovery must include the specific exception on which the company is relying, and should provide additional context relating to that exception, such as a brief explanation of the direct expenses paid to a third party to assist in enforcing the recovery policy, identification of the provision of foreign law that recovery would violate, or a description of how recovery would cause a tax-qualified retirement plan to fail to meet the applicable statutory requirements.

The new Item 402(w) disclosure requirement is separate from the compensation discussion and analysis (CD&A) requirement, but a listed company could choose to include it in its CD&A discussion if it is required to prepare a CD&A discussion.

Additionally, if at any time during or after its last completed fiscal year a company was required to prepare an accounting restatement, and concluded that recovery of erroneously awarded compensation was not required pursuant to the company's compensation recovery policy required by the listing standards adopted pursuant to Rule 10D-1, the company must briefly explain why application of its recovery policy resulted in this conclusion.

Information disclosed pursuant to Item 402(w) will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 unless specifically so incorporated. Finally, the compensation recovery disclosures must have specific data points tagged, as well as block text tagging of the disclosures, in Inline XBRL.

Summary Compensation Table Revisions. When prior year compensation disclosed in a summary compensation table has been recovered, the amount shown in the applicable column and the total column of the summary compensation table must be reduced to include only the amount retained by the executive officer, with a footnote explaining the recovery. For example, if the company reported that in 2024 its chief executive officer earned \$1 million in non-equity incentive plan compensation, and in 2025 a restatement of 2024 financial statements resulted in recovery of \$300,000 of that compensation, the company's 2025 summary compensation table would revise the 2024 reported amount for non-equity incentive plan compensation to \$700,000, provide footnote disclosure explaining that the company recovered \$300,000 of previously reported compensation, and make a comparable change to 2024 total compensation for such officer.

Additional Check Boxes. To promote greater transparency around accounting restatements generally, the cover page to Form 10-K, Form 20-F, and Form 40-F will include new check boxes where companies must indicate separately: (1) whether the financial statements included in the filing reflect correction of an error to previously issued financial statements, and (2) whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the company's executive officers during the relevant recovery period pursuant to Rule 10D-1.

Transition Period

Securities exchanges must file their proposed listing standards within 90 days after the publication of Rule 10D-1 in the *Federal Register*. The new listing standards must be effective no later than one year following the date Rule 10D-1 is published in the *Federal Register*.

Once clawback listing standards become effective, each company with securities listed on the applicable exchange must adopt a compliant clawback policy within 60 days. The clawback requirement applies to erroneously awarded compensation received on or after the effective date of the applicable listing standard.

Listed companies would have to include the new clawback disclosures in proxy or information statements and Exchange Act annual reports filed on or after the effective date of the listing standards.

Practical Considerations

Time Frame for Clawback Requirement. Listing standards must be effective within one year from the date that the final rule is published in the *Federal Register*. Then, companies have 60 days to adopt a compliant policy. Notwithstanding that the clawback policies may not be required to be adopted until sometime in late 2023 or early 2024, Rule 10D-1 will apply to any incentive-based compensation “received” on or after the effective date of the applicable listing standard, even if that compensation arose out of a contract or arrangement that existed prior to the effective date of Rule 10D-1.

While companies have some time to design and adopt the clawback policy required by the final rule, because such policy may be required to apply to contracts and arrangements that exist prior to the effective date of Rule 10D-1, companies should consider whether to add provisions to any grants of incentive compensation in 2022 and 2023 that make it clear that the executive is consenting to the application of any clawback policy adopted by the company to comply with Rule 10D-1 to all incentive compensation awards held by such executive officer. Enforcement of such clawback policy may depend on a state law analysis of contractual rights of the company and the executive officers with respect to incentive compensation granted by the company, and obtaining written consent from the executive to the application of such policy to all incentive compensation held by such executive as an express condition for receiving any grants of incentive compensation put the company in a better position to enforce any clawback policy adopted by the company to comply with the final rule (the adopting release makes it clear that state law issues are not a valid reason for a company to not be able to comply with the requirements of Rule 10D-1 so the company needs to make sure that it is able to enforce the clawback policy requirements under applicable state law).

Preparations for Clawback Policies. Rule 10D-1 does not include an exemption from a clawback based on the fact that the recovery of compensation would violate the terms of an existing agreement. Therefore, listed companies should review existing governance and executive compensation documents to determine if there are any existing provisions that would violate the new required clawback policy, such as provisions prohibiting clawbacks, indemnifying executive officers from clawbacks or requiring company-paid insurance coverage with respect to recovered compensation. Additionally, as noted above, listed companies may also want to consider adding provisions to new executive compensation documents even prior to the effective date of the final rule acknowledging that executive officer compensation is subject to clawback policies that the company adopts to comply with Rule 10D-1.

Listed companies should consider whether they want to update their compensation committee charter to address clawback responsibilities.

Whether a company has an existing clawback policy, adopts one before the applicable listing standards become effective, or plans to wait until the listing standards are effective before adopting a clawback policy, it is important for listed companies to monitor this rulemaking and bring it to the attention of their compensation committee and perhaps their full board of directors. Following the adoption of listing standards by the applicable securities exchange, all listed companies will need a compliant clawback policy within 60 days. Therefore, now that the SEC has adopted the final rules, listed companies should use the time to consider what steps they will take to comply with the clawback requirement.

Since the passage of the Dodd Frank Act in 2010, many companies have adopted executive compensation recovery policies that cover not only accounting restatements, but a variety of other circumstances and conduct. While broader in scope, the policies typically contain, in contrast to Rule 10D-1, provisions that require a finding of fault on the part of the executive whose compensation is the subject of recovery, as well as provisions that give the board or a committee of the board substantial discretion whether to pursue recovery.

In the course of modifying existing executive compensation recovery policies to conform to Rule 10D-1, companies should consider the extent to which it wishes to preserve those elements of its existing clawback policy and take care in drafting revisions to avoid their inadvertent deletion. Similarly, a company's existing policy may permit recovery of compensation paid in the event of a restatement from a broader group of individuals than are covered by Rule 10D-1, in which case the company should consider whether the policy adopted to comply with Rule 10D-1 should apply equally to those other individuals. For ease of drafting, it may be desirable to create a separate policy that complies with Rule 10D-1 and which is intended to supplement, rather than replace, the company's existing executive compensation recovery policy.

Compensation Decisions. When documenting the basis on which the compensation committee grants equity and non-equity awards, care should be taken to minimize any ambiguity as to whether the awards are subject to recovery as incentive-based compensation, in whole or in part, in the event of a later financial statement restatement. The basis for the grant of the compensation may cause certain cash payments or equity grants that would not otherwise appear to be incentive-based to be subject to the clawback policy.

For example, many listed companies use a two-step process for making equity grants to certain executive officers (although this approach was more common as an approach to make sure compensation was considered performance-based compensation within the meaning of Section 162(m) prior to the elimination of the performance-based compensation exception in 2017, many companies still use this approach when making annual grants to employees). For the first step, the listed company sets a performance goal annually to create a pool of equity awards that may be granted to employees following such year and makes the grant of restricted stock or restricted stock units from such pool if the performance goal is satisfied. If the goal is not met, no restricted stock units are granted to the executive officers and other employees. If it is met, then, as the second step, a stock pool is established pursuant to which the listed company can make discretionary equity grants (subject only to service-based vesting after the date of grant) to the executive officers and other employees. A listed company might not consider a restricted stock grant that is subject only to service-based vesting after the date of grant as incentive-based compensation. However, the restricted stock grant may be subject to the clawback policy because the two-step approach conditions the grant of such restricted stock on the satisfaction of the goal established in the first step.

Similar care should be taken in drafting the CD&A section of the proxy statement. The company will want to avoid later claims by stockholders that the company should seek to recover a portion, or a larger portion, of the executive's compensation because of the way the compensation was characterized in the CD&A discussion. For example, a statement that an executive received a service-based equity award of a particular size in recognition of the achievement of certain financial results may raise the question as to whether that award constitutes compensation "... granted ... based wholly or in part upon the attainment of a financial reporting measure" and therefore subject to recovery in the event of an accounting restatement. In this regard, it should be pointed out that the definition of "incentive-based compensation" under Rule 10D-1 does not conform to the definitions used for classifying compensation in the Summary Compensation Table in a company's proxy statement. In fact, the adopting release notes that in some circumstances a salary increase may constitute incentive-based compensation for purposes of Rule 10D-1.

Impact of Pre-Tax Recovery. The requirement that the recoverable amounts be calculated on a pre-tax basis could cause the executive officer to be required to pay back more on an after-tax basis than the officer originally received. At a minimum, the officer could have a liquidity issue when required to repay the company. In addition, while the tax treatment of the repayment will depend on the executive's specific tax situation, the taxes paid on the original excess payment may not be fully recoverable from the applicable taxing authority.

Executive Officer Determinations. The definition of executive officers for the required clawback policy includes at a minimum, any individual identified by the company as an executive officer for purposes of its Form 10-K disclosure. As a result, the determination of executive officer status is more consequential than before. Accordingly, now may be a good time for companies to review which officers they identify as executive officers to make sure they are comfortable with that designation.

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Endnotes

¹ Release Nos. 33-11126; 34-96159 available at:

[Final Rule: Listing Standards for Recovery of Erroneously Awarded Compensation \(sec.gov\)](#)