

SEC'S FINAL CLAWBACK RULES: WHAT TO KNOW

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Executive Compensation



Key Takeaways

- **Have policy amendments ready in 2023.** All public companies should adopt written compliant clawback policies within 60 days of the effective dates of their respective exchanges.
- **Widely broadened definition of restatements subject to clawbacks.** The broader definition of “restatement” leads WTW to expect an increase in overall enforcement of clawbacks, which illuminates the importance for boards to ensure proper documentation/minutes going forward.

enforcement was in the best interest of the company or the shareholders.

- **Three exceptions to the rule.** Three exceptions to the board discretion rule relate to cost of recovery, violation of home country laws or tax-qualified retirement plan terms.
- **Act now.** WTW recommends immediate action to adopt a clawback policy that complies with the new rules and an immediate health check on current governance processes in advance of potential enforcement of a clawback policy.



The U.S. Securities and Exchange Commission's (SEC) long intermission on clawbacks is over.

the SEC's denouement, issuers must adopt written compliant clawback policies within 60 days of the effective dates of their respective exchanges; *said another way*, have policy amendments ready in 2023.

The Basics

With minimal exceptions, the no-fault clawback rules apply to all listed companies with no carve-out or special phase-in exceptions for emerging growth companies (EGCs), smaller reporting companies (SRCs), controlled companies or foreign private issuers.

Partial justification for the SEC's application of its rules immediately and more broadly across issuers was based on the SEC's stated findings that EGCs and SRCs were (and presumably are) specifically more likely to lack internal controls.

Such an internal control deficiency could reasonably result in reported accounting errors and material weaknesses in financial reporting, according to the SEC. The moral of the story is that the rules likely apply to you.

What's Changed?

Luckily, most issuers have some form of written clawback policy. Those without one would start with a blank sheet of paper. The majority, however, would need to ensure that their written policy meets at least some minimal requirements.

Since the new rules operate under a "no-fault" regime, boards must clawback any incentive compensation received by former or current executive officers in the past three years regardless of any personal culpability related to a financial restatement.

Notably, unlike the originally proposed rules, the final rules require clawbacks for "little r" restatements based on the SEC's estimation that that there are

subject to clawbacks. Since proposed rules only applied to “Big R” restatements, many issuers relying on the proposed rules drafted narrower clawback policies than will now be required. The broader definition of “restatement” leads WTW to expect an increase in overall enforcement of clawbacks, which illuminates the importance for boards to ensure proper documentation/minutes going forward — particularly if they choose not to enforce a clawback policy under a stated exception discussed later.

“Incentive compensation” subject to clawback for Big R or little r restatements broadly includes annual bonuses, performance bonuses, performance shares, performance cash and any other compensation based on attaining financial reporting measures.

Also broadly defined, “financial reporting measures” include generally accepted accounting principles (GAAP) standards that are determined and presented in accordance with the accounting principles used in preparing the issuer’s financial statements and certain non-GAAP measures, metrics and ratios if derived wholly or in part from such measures.

They may or may not be included in a filing with the commission, and may be presented outside the financial statements, such as in the performance graph or Management’s Discussion and Analysis of Financial Conditions and Results of Operations.

Ousted with the old rules is the once-allowed board discretion to balance and consider all factors to decide whether clawback enforcement was in the best interest of the company or the shareholders.

The three exceptions to the rule, which we often see in current policies where boards have discretion to enforce clawbacks, relate to cost of recovery, violation of home country laws or tax-qualified retirement plan terms. The

executives' loss of incentive compensation upon clawback enforcement. Last, all amounts subject to the clawback must be recovered "reasonably promptly;" a term not specifically defined but based on individual facts and circumstances.

WTW expects a significant increase in clawback enforcement disclosures and recommends immediate action to adopt a clawback policy that complies with the new rules.

WTW also recommends an immediate health check on current governance processes in advance of potential enforcement of a clawback policy.

Editor's Note: Additional Content

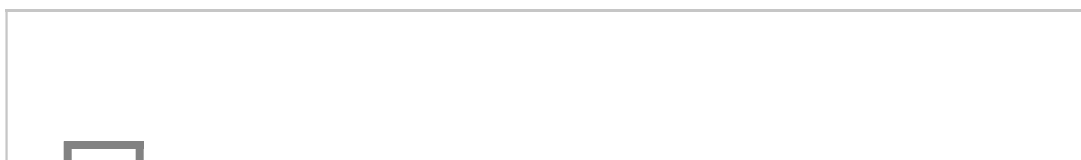
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