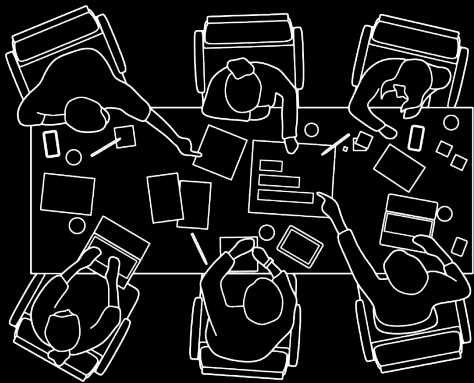


Davis Polk

SEC clawback rule – Practical tips for adopting and administering the new requirements

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June 7, 2023

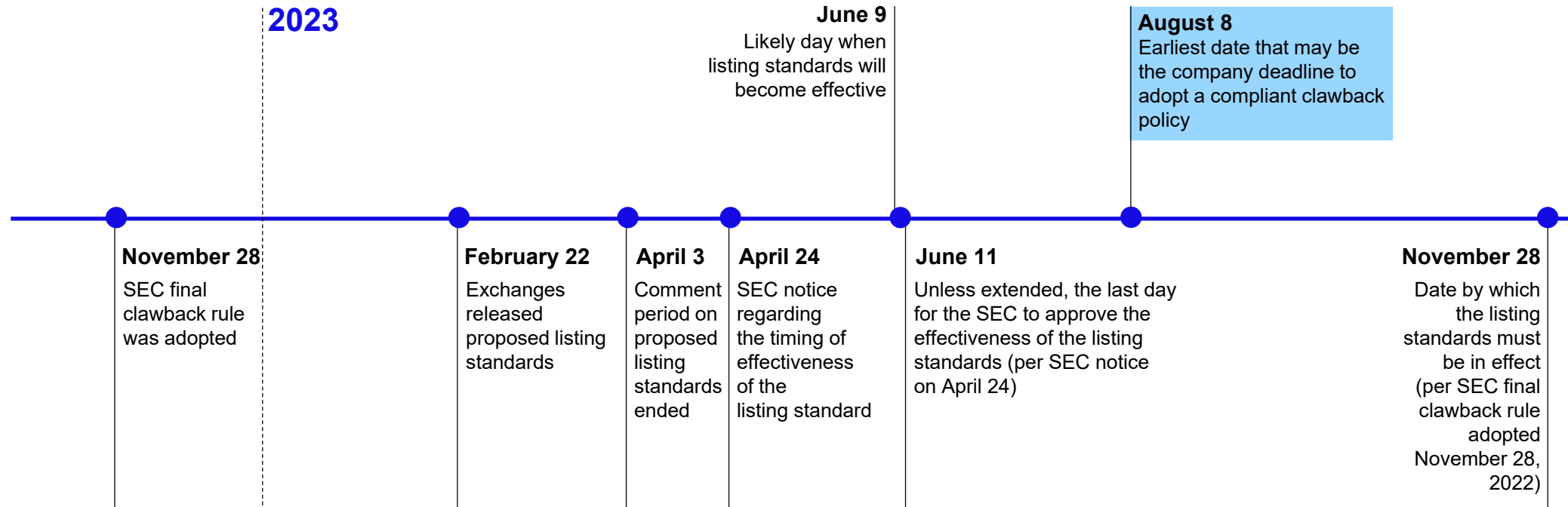


Overview

Under a requirement that dates back to the 2010 Dodd-Frank Act, but is just now being implemented, all listed companies will be required to adopt a clawback policy mandating recovery of “excess” compensation that was “erroneously” paid. The deadline for companies to act hasn’t been finalized yet, but could be as early as August 8, 2023.

Timing to adopt policy

Companies have 60 days from the effective date of the listing standards to adopt a compliant clawback policy.

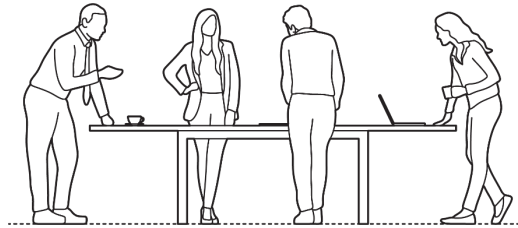


*Timing, other than the November 28, 2023 date, is subject to change

Note: Compensation received on or after the effective date of the listing standard for goals attained in FY 2023 and later will potentially be subject to clawback. For more, see slide 8.

Covered individuals

All current and former **Section 16 officers** who served during the relevant **three-year lookback period**, except for compensation received before becoming a Section 16 officer.



Events that trigger clawbacks

“Big R” restatements

These restatements correct an error material to previously issued financial statements.

“little r” restatements

These restatements correct an error that would result in material misstatement if (a) left uncorrected in current period or (b) correction recognized in current period.

Recovery is mandatory and no misconduct is required.

Compensation subject to clawback

Subject to clawback

- Incentive compensation based on “**financial reporting measures**,” which include
 - measures determined and presented in accordance with accounting principles used to prepare financial statements and measures derived wholly or in part from such measures, including GAAP and non-GAAP measures
 - stock price
 - total shareholder return (TSR)
- Amounts contributed to benefit plans on the basis of financial reporting measures and any earnings accrued thereon
 - Includes long-term disability, life insurance, supplemental retirement and severance plans

Not subject to clawback

- Salary
- Time-vesting awards
- Compensation awarded on the basis of subjective, strategic or operational measures
- Discretionarily awarded compensation
- Compensation contributed to tax-qualified retirement plans

Years of compensation subject to clawback:

Determined based on goals attained in any of the **three completed fiscal years**, beginning with FY 2023, preceding the earlier of (i) the date the board / committee / authorized officers conclude, or reasonably should have concluded, that a restatement is required and (ii) the date a court / regulator / otherwise legally authorized body directs the company to undergo a restatement.

An hourglass with blue liquid inside, set against a blue background. The liquid is more concentrated in the top bulb, with some dripping into the bottom bulb.

Recovery

- Mandatory recovery
- Pre-tax amount subject to clawback
- Issuers are permitted to exercise discretion on the method of recovery, as long as reasonably prompt under the particular facts and circumstances
 - **Forfeiture** of equity awards or **cancellation** of unvested equity and non-equity awards.
 - **Offsetting** against amounts otherwise payable to the executive officer.
 - Recovery **over time** or from **future** pay.
 - **Repayment** by the executive officer.
- Enforcing a clawback with respect to amounts that would be treated as **nonqualified deferred compensation** under **Section 409A** of the Internal Revenue Code should be done carefully to avoid changing the time and form of payment.

Adopting a policy: Considerations when putting a clawback policy in place

While the rules are fairly prescriptive on the required parameters of a clawback policy, there are a few questions and considerations that companies will face when adopting a policy.

- Should the policy be adopted and administered by the Board or the Compensation Committee?
- Should the policy be limited to the prescribed group of executive officers or should it cover a broader group?
- Should the policy be limited to clawbacks relating to financial restatements or should the policy also cover elective clawbacks?
- Do we need to adopt a policy if we have no compensation based on financial reporting measures?

The financial restatement process

- What financial restatements are covered?
- How do companies determine the type of restatement?
- Who is involved with the restatement at each point in the process?
- What are the first steps once it is determined that a restatement will be required?

Disclosure of policies, restatements and clawback events

- When does the policy first need to be disclosed?
- What disclosure is required if a “Big R” or “little r” restatement occurs?
- What disclosures do companies need to make in the event of a clawback?
- How is the excess compensation amount calculated, and what needs to be disclosed?
- Do companies need to disclose anything if they determine there is no excess compensation or recovery would be impracticable?
- What happens if a company fails to comply with the disclosure requirements?

Other practical considerations

- How to collect recoupment amounts
- Tax implications
- Plan design considerations
- Special considerations for FPIs
- Other governance considerations for clawback policies
 - Possible new rules for banks
 - Clawbacks for misconduct

The upshot

01

Identify the officers whose compensation is subject to clawback – special considerations if an officer is based outside of the United States

02

Identify the compensation arrangements that are subject to clawback – note benefit plan contributions

03

If there is an existing clawback policy, perform a gap analysis

04

Adopt a compliant clawback policy and ensure that Legal, HR, and Finance are coordinated if a restatement should ever arise

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