

## FINAL CLAWBACK RULES

25 JULY 2023 • ARTICLE



**"The Clawback Rules require U.S. public companies to develop and adopt a recoupment policy facilitating the recovery of incentive-based compensation received by current or former executives."**

### OVERVIEW

The Securities and Exchange Commission (the "SEC") adopted "Clawback Rules," codified in Rule 10D-1 of the Securities Exchange Act of 1934, as amended. The Clawback Rules require U.S. public companies to develop and adopt a recoupment policy facilitating the recovery (or "clawback") of incentive-based compensation received by current or former executives. In accordance with Rule 10D-1 and to provide for such clawback requirements, the New York Stock Exchange ("NYSE") and the Nasdaq Stock Market ("Nasdaq") each amended its relevant listing standards – the NYSE through Section 303A.14 of the NYSE Listed Company Manual and Nasdaq through Listing Rule 5608.

### PURPOSE OF THE CLAWBACK RULES

In the spirit of fairness and in accordance with the language and legislative history of the Dodd-Frank Act, the SEC determined that an executive officer is not entitled to incentive-based compensation if, under an accurate accounting, the officer would have not earned it originally.

The SEC quoted a 2010 report from the Senate Committee on Banking, Housing and Urban Affairs stating that it is "unfair to shareholders for corporations to allow executive officers to retain compensation that they were awarded erroneously," further indicating that shareholders should not "have to embark on costly legal expenses to recoup their losses" and that "executives must return monies that should belong to the shareholders." As such, this rule applies irrespective of any fault on the part of the executive officer for the accounting errors. In the same vein, an executive officer or former executive officer cannot be indemnified against the loss of erroneously awarded compensation.

### CLAWBACK REQUIREMENTS

**"Each NYSE and Nasdaq listed company must adopt a clawback policy."**

Each NYSE and Nasdaq listed company must adopt a clawback policy. NYSE and Nasdaq compliant policies must provide that a company will recover or "clawback" improperly awarded incentive-based compensation from current and former executive officers, where there is an accounting restatement resulting from the issuer's material noncompliance with any financial reporting requirement under securities laws. A clawback may be triggered by either of the two types of accounting restatements: (1) "Big R" or "reissuance" restatements, which restate

historical financial statements to update or correct material errors or omissions from prior periods, or (2) "little r" or "revision" restatements, where companies correct errors from prior periods that are immaterial to previously issued financial statements, but would result in a material misstatement if left uncorrected or if the correction were to be recognized in a current financial statement. By contrast, when an error is considered immaterial both to the previously issued financial statements and the current period, and it is recorded as an "out-of-period adjustment" in the current financial statements, the clawback would not apply. An "out-of-period adjustment" is the correction of an error to financial statements outside of the original reporting period when the error is deemed immaterial to both the initial period and the current reporting period.

Incentive based compensation is compensation based in whole or in part on a financial reporting measure, which is determined and presented in accordance with the accounting principles used in preparing the company's financial statements, share price or total shareholder return. If an increase in salary is based upon performance of the company, for example, such increase in salary may be deemed incentive based.

The policy must provide for recovery of any erroneously awarded compensation received during the three completed fiscal years (plus any transition period of less than nine months that is within or immediately following those three completed fiscal years and that results from a change in the Company's fiscal year) immediately preceding the date the issuer is required to prepare the accounting restatement and all incentive-based compensation "received" on and after October 2, 2023 is subject to clawback.

The recoverable amount subject to clawback is the difference between the incentive-based amounts actually received by the executive and the incentive-based amounts that would have been received based on the restated amount, computed without regard to any taxes paid.

**"Listed companies have 60 days following the October 2, 2023 effective date to adopt their clawback policies. As such, compliant clawback policies must be adopted no later than December 1, 2023."**

## EXCEPTIONS

The listing standards provide for three exceptions to the mandated clawback of erroneously awarded compensation:

- when the cost paid to a third party to assist in enforcing the policy would exceed the amount to be recovered;
- when recovery would violate a listed company's home country law adopted prior to November 28, 2022, and the issuer provides an opinion of home country counsel to the exchange; and
- when recovery would likely cause an otherwise tax-qualified retirement plan to fail to meet the requirements of the U.S. Internal Revenue Code.

# WATSON FARLEY & WILLIAMS

In each instance, an issuer's committee of independent directors responsible for executive compensation decisions (or a majority of the independent directors serving on the board if no such committee exists), must make a determination that recovering the compensation would be impracticable.

## DEADLINE TO ADOPT CLAWBACK POLICIES

Listed companies have 60 days following the October 2, 2023 effective date to adopt their clawback policies. As such, compliant clawback policies must be adopted no later than December 1, 2023. Additionally, compensation clawback disclosures must be disclosed as an exhibit to an issuer's annual report and proxy and information statements filed on or after October 2, 2023. A company is also required to recover erroneously awarded compensation, as required by its clawback policy, in a "reasonably prompt" fashion.

## APPLICABILITY OF LISTING STANDARDS

The Clawback Rules apply to any company that has securities listed on a U.S. national securities exchange that is registered under Section 6 of the Securities Exchange Act of 1934. Companies subject to the Clawback Rules include foreign private issuers, emerging growth companies, smaller reporting companies, controlled companies and issuers of debt and other non-equity securities. Certain security futures products, standardized options, and securities issued by unit investment trusts are not affected by the new rules. Certain registered investment companies that have not awarded incentive-based compensation in the past three fiscal years are not required to adopt compensation recovery policies or provide the related disclosure.

This article was written by Partner Steven Hollander and Associate Krisly Zamor. If you have any questions, please contact one of the authors or your regular Watson Farley & Williams contact.

## KEY CONTACTS



**STEVEN HOLLANDER**  
PARTNER • NEW YORK

T: +1 212 922 2252

[shollander@wfw.com](mailto:shollander@wfw.com)



**FILANA R. SILBERBERG**  
PARTNER • NEW YORK

T: +1 212 922 2225

[fsilberberg@wfw.com](mailto:fsilberberg@wfw.com)



**WILL VOGEL**  
PARTNER • NEW YORK

T: +1 212 922 2280

[wwogel@wfw.com](mailto:wwogel@wfw.com)



**KRISLY ZAMOR**  
ASSOCIATE • NEW YORK

T: +1 212 922 2203

[KZamor@wfw.com](mailto:KZamor@wfw.com)

# WATSON FARLEY & WILLIAMS

## DISCLAIMER

Watson Farley & Williams is a sector specialist international law firm with a focus on the energy, infrastructure and transport sectors. With offices in Athens, Bangkok, Dubai, Dusseldorf, Frankfurt, Hamburg, Hanoi, Hong Kong, London, Madrid, Milan, Munich, New York, Paris, Rome, Seoul, Singapore, Sydney and Tokyo our 700+ lawyers work as integrated teams to provide practical, commercially focussed advice to our clients around the world.

All references to 'Watson Farley & Williams', 'WFW' and 'the firm' in this document mean Watson Farley & Williams LLP and/or its affiliated entities. Any reference to a 'partner' means a member of Watson Farley & Williams LLP, or a member, partner, employee or consultant with equivalent standing and qualification in WFW Affiliated Entities. A list of members of Watson Farley & Williams LLP and their professional qualifications is open to inspection on request.

Watson Farley & Williams LLP is a limited liability partnership registered in England and Wales with registered number OC312252. It is authorised and regulated by the Solicitors Regulation Authority and its members are solicitors or registered foreign lawyers.

The information provided in this publication (the "Information") is for general and illustrative purposes only and it is not intended to provide advice whether that advice is financial, legal, accounting, tax or any other type of advice, and should not be relied upon in that regard. While every reasonable effort is made to ensure that the Information provided is accurate at the time of publication, no representation or warranty, express or implied, is made as to the accuracy, timeliness, completeness, validity or currency of the Information and WFW assume no responsibility to you or any third party for the consequences of any errors or omissions. To the maximum extent permitted by law, WFW shall not be liable for indirect or consequential loss or damage, including without limitation any loss or damage whatsoever arising from any use of this publication or the Information.

This publication constitutes attorney advertising.