

## Publications

### SEC Adopts New Executive Compensation Clawback Rules

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On October 26, 2022, the U.S. Securities and Exchange Commission (SEC) adopted *new rules* directing the national securities exchanges and associations to establish listing standards that require public companies to implement and disclose a policy providing that, in the event a company is required to prepare an accounting restatement, the company will recover (or clawback) incentive-based compensation paid to its current and former executive officers based on any erroneous financial information. Unlike the clawback policies currently maintained by many public companies (and Section 304 of the Sarbanes-Oxley Act), the clawback policy that will be required by the new rules and listing standards will require recovery of incentive compensation regardless of the culpability of the executive officer. In addition, the new rules and listing standards will mandate the clawback of incentive compensation received during the three-year period preceding the date the company is required to prepare an accounting restatement.[1]

### Basis and Purpose of the New Rules

The new clawback rules, initially proposed in 2015, implement Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which added Section 10D of the Securities Exchange Act of 1934 (Exchange Act). The stated purposes of the clawback rules are to (i) ensure executive officers of public companies do not retain incentive-based compensation awarded to them based on materially misreported financial information and (ii) enable companies to avoid incurring costly legal expenses to recoup such compensation from executive officers for the benefit of the shareholders.

### Structure of New Exchange Act Rule 10D-1

Exchange Act Rule 10D-1 sets forth the listing requirements which national securities exchanges and associations are directed to adopt. Exchanges and associations must delist companies which fail to comply with such listing requirements. Rule 10D-1 applies to all listed issuers of equity securities (including emerging growth companies and

smaller reporting companies), with limited exceptions.

## Listing Requirements

The listing requirements to be adopted by the securities exchanges and associations will require each listed company to adopt and comply with a clawback policy and provide the disclosures required by Rule 10D-1 and applicable SEC filing forms.

### *Clawback Policy Requirements*

The new listing requirements will require listed companies to adopt and comply with a written policy providing that the company will recover the amount of erroneously awarded incentive-based compensation from current and former executive officers if 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.<sup>[2]</sup>

The clawback policy is triggered by the requirement to prepare an accounting restatement. A company is required to prepare an accounting restatement upon the happening of the earliest to occur of:

- the date the company's board of directors, committee of the board of directors, or authorized officer 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, including any required accounting restatement to correct an error in previously issued financial statements that is material to the previously issued financial statements, or that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period; or
- the date a court, regulator, or other legally authorized body directs the company to prepare such an accounting restatement.

The clawback policy must apply to (i) the three completed fiscal years immediately preceding the date that the company is required to prepare an accounting restatement, and (ii) any current or former executive officer of the company (i.e., a Section 16 reporting officer) who received incentive-based compensation within such three-year period, regardless of whether such executive officer had a direct role in financial reporting. The company's obligation to recover erroneously awarded compensation does not depend on if or when the restated financial statements are filed by the company.

The incentive-based compensation subject to the clawback policy will equal the amount of incentive-based compensation received in excess of the amount of incentive-based compensation that would have been received if it had been determined based on the restated amounts, without any adjustment for any taxes paid. Incentive-based compensation includes any compensation granted, earned, or vested based wholly or in part upon the attainment of a financial reporting measure, and executive officers will be deemed to receive incentive-based compensation in the fiscal period during which the financial reporting measure is attained regardless of when it is actually paid.<sup>[3]</sup>

A public company's board of directors must pursue recovery under the company's clawback policy unless the direct cost of recovery would exceed the amount of the recovery. The policy may grant the board of directors' discretion in how to recover amounts under the clawback policy.

### ***Disclosure Requirements***

Public companies will be required to disclose the implementation of the clawback policy, modify financial statements to reflect compensation recouped pursuant to the company's clawback policy, and attach the clawback policy to its Annual Report on Form 10-K.

## **Transition and Timing of New Rules**

The new rules will become effective 60 days following publication in the Federal Register, following which the exchanges and associations must file proposed listing standards within 90 days of publication and new listing standards must be effective no later than one year following such publication. Companies subject to the new listing standards will be required to adopt a compliant clawback policy no later than 60 days following the date on which the applicable listing standards become effective.

***Vorys represents issuers and investors in nearly all aspects of federal and state securities law compliance and nearly all types of public and private securities and capital markets transactions. Please visit our website to obtain more information regarding our [Securities Law Compliance and Corporate Governance practices](#).***

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<sup>[1]</sup> Under the new rules and listing standards, incentive compensation recovery will be triggered by both "Big R" and "little r" restatements. "Big R" restatements result from an error that is material to previously issued financial statements. "Little r" restatements result from an error that is material to the current period financial statements if left uncorrected or if the correction were recorded only in the current period. In a "Big R" restatement, financial statements for prior periods are restated and reissued, and users are notified that financial statements previously filed with the SEC should no longer be relied upon. In a "little r" restatement, errors are corrected in comparative financial statements for the current period by revising the information for the prior periods in the current period financial statements are issued, without reissuing the financial statements for the prior periods.

<sup>[2]</sup> Companies may adopt more extensive clawback policies, so long as those policies at a minimum satisfy the requirements of Rule 10D-1.

<sup>[3]</sup> The clawback policy must apply to pre-existing contracts and arrangements related to executive officer incentive-based compensation.