

SEC Proposes Rules to Implement Compensation Recovery (“Clawback”) Requirement

On July 1, 2015, the SEC proposed rules to implement Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. This provision requires the SEC to direct the national securities exchanges to amend their listing standards to require public companies to adopt and disclose their written clawback policy to maintain their listing status. Public comment on the SEC’s proposed rules must be submitted within 60 days of their publication in the Federal Register, which we expect will take place shortly. Accordingly, comments will be due by mid-September.

This Thoughtful Pay Alert summarizes the key aspects of the SEC’s proposed rules. For a more detailed description of the SEC rules and our initial observations about the likely impact of this new requirement on technology and life sciences companies, see [our detailed article](#).

Background

To enhance the operation of executive compensation programs, Section 954 of the Dodd-Frank Act added new Section 10D to the Securities Exchange Act of 1934. This provision requires the SEC to direct the national securities exchanges to prohibit the listing of any company that has not developed and adopted a compensation recovery (“clawback”) policy providing for the recovery of excess incentive-based compensation from any of its current or former executive officers who received such compensation as the result of a material error that required the company to prepare a financial restatement.

On July 1, 2015, the SEC proposed rules that would direct the national securities exchanges to revise their listing standards to comply with Section 10D. These proposed rules would also require listed companies to disclose specific information about their clawback policy and its enforcement in their annual report on Form 10-K and proxy or information statement.

Clawback Policy Requirement

As proposed, listed companies would be required to adopt and comply with a clawback policy in which:

- **Covered Executives** – recovery would be required from current and former executive officers based on the Section 16 definition of “officer.”
- **Triggering Event** – recovery would be triggered if the company is required to prepare an accounting restatement to correct a material error. Recovery would be required without regard to whether any misconduct occurred or an executive officer’s responsibility for the erroneous financial statements.
- **Compensation Recoverable** – recovery would apply to any cash or equity compensation (including stock options) granted, earned, or vested on the basis, in whole or in part, of a “financial reporting measure,” which would be defined to include any measure that is determined and presented based on the accounting principles used in preparing financial statements, as well as stock price and total shareholder return. Significantly, time-based stock options would not be subject to the clawback policy.
- **Recovery Period** – recovery would apply to any incentive compensation received during the three fiscal years preceding the date when the financial restatement is required.
- **Amount to be Recovered** – recovery would be required of the amount of incentive compensation received that exceeds the amount that would have received had the compensation been determined based on the accounting restatement. In the case of compensation based on stock price or TSR, companies may use a reasonable estimate of the effect of the restatement on the applicable measure to determine the amount to be recovered.
- **Recovery Mandatory** – recovery of any excess incentive compensation would be mandatory, with two

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limited exceptions: recovery would not be required if the direct costs of seeking recovery would exceed the recoverable amount or recovery would violate the company’s home country laws.

Disclosure Requirement

Listed companies would be required to file their clawback policy with the SEC as an exhibit to their annual report on Form 10-K.

In addition, if during its last completed fiscal year a listed company either completed a financial restatement that required recovery of excess incentive compensation, or there was an outstanding balance of excess incentive compensation from a prior restatement, the company would be required to disclose in its proxy statement:

- the date on which it was required to prepare the restatement;
- the aggregate dollar amount of excess incentive compensation attributable to the restatement;
- if the incentive compensation was determined based on a stock price or TSR-related financial reporting measure, the estimates used to determine the excess compensation attributable to the restatement;
- the aggregate dollar amount of such excess incentive compensation that remains outstanding at the end of its last completed fiscal year;
- the name of each person subject to recovery of excess incentive compensation attributable to the restatement, if any, from whom the company decided not to seek recovery, the amount forgone for each such person, and a brief description of the reason the company decided in each case not to seek recovery; and
- the name of, and amount due from, each person from whom, at the end of the last completed fiscal year, excess incentive compensation had been outstanding for 180 days or longer since the date the company determined the amount the person owed.

Transition Period and Effective Date

As proposed, the national securities exchanges would be required to file their proposed listing standards with the SEC no later than 90 days following the publication of the final SEC rules in the Federal Register and further required

to have the listing standards become effective no later than one year following this publication date. Compliance by listed companies will likely be required in late 2016 or, more probably, 2017.

Need Assistance?

Compensia has extensive experience in helping companies understand how the corporate governance and executive compensation-related disclosure provisions of the Dodd-Frank Act will affect the design, operation, and disclosure of their executive compensation program. If you would like assistance in analyzing how the proposed rules are likely to impact your executive compensation program and disclosure, or if you have any questions on the subjects addressed in this Thoughtful Pay Alert, please feel free to contact Mark A. Borges. ■

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