

Evolution of Clawback Policies and Accounting Implications

February 27, 2015 | Client Update | 2-minute read

Several shareholder proposals this season ask boards to adopt clawback policies that would be triggered by any misconduct resulting in a violation of law or policy that causes significant financial or reputational harm, where a senior executive either committed the misconduct or failed to supervise subordinates. The proposals also ask those companies to disclose to shareholders the circumstances of any recoupment and any board decision not to pursue recoupment.

This type of clawback policy, particularly the disclosure component, is unusual. [PwC's study](#) on clawbacks as disclosed in proxy statements found that 90% of clawback policies are triggered by a financial restatement. 73% of those require evidence that the employee caused or contributed to the false reporting. The clawback amount is usually the excess that was paid compared to the compensation if no restatement had occurred.

The study analyzes the clawback policies of 100 large public companies as disclosed between 2009 and 2013. Many companies had clawback policies that contained more than one trigger event. 83% included both financial and other misconduct as a reason to clawback. Other types of clawback triggers included any form of fraud, violation of non-compete or non-solicitation agreements, breach of corporate confidentiality or failure to supervise subordinates. In addition, financial services firms often addressed inappropriate risk-taking by executives, implicated when employees violate risk policies or risk thresholds.

In terms of individuals covered, 62% applied clawbacks only to senior executives, while 28% covered all employees or participants and 9% limited it to NEOs. 86% allowed companies to recover both cash and stock. Generally, there is no blanket discretion for determining whether an event triggers a clawback. However, 76% permitted discretion in determining the consequences, such as the extent of the recoupment.

As the terms of clawback provisions evolve, companies need to be aware of the possible accounting implications. PwC's study noted that under existing accounting rules, a traditional clawback feature does not impact the equity award's value and expense pattern, so that if the clawback were ever invoked, accounting recognition would only be needed at that time to reflect the recoupment.

However, if performance metrics that affect vesting or retention of the award are added, then those features could be considered performance conditions of the award and possibly complicate the accounting. In addition, having the flexibility or discretion to determine when or if a clawback has been triggered and the amount to be recouped may impair the need to meet the criteria for a grant date, if there is an assessment that the key terms and conditions of the grant are not established and understood.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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