

SEC Issues Rule Proposal on Clawback of Executive Compensation

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At an open meeting yesterday, the Commission voted to propose broad rules directing the national exchanges and associations to establish listing standards requiring companies to develop and implement clawback policies. We will issue a client memo on the proposal shortly. The key provisions are complex and are set forth below, based on the [fact sheet](#) released by the SEC:

Companies covered: all listed companies, including foreign private issuers, emerging growth companies and controlled companies

Applicable executives: current and former executive officers modeled on Section 16 of the Exchange Act

Incentive-based compensation subject to recovery: any incentive-based compensation that is granted, earned or vested, based wholly or in part on the attainment of any “financial reporting measure”

Financial reporting measure: measures based on the accounting principles used in preparing a company’s financial statements, any measures derived wholly or in part from such financial information, and stock price and total shareholder return

No-fault clawback trigger: The trigger for a clawback is an accounting restatement to correct a material error. The recovery is not based on the finding of any misconduct or even an executive being found responsible for the financial statement error.

Time period of compensation subject to recovery: incentive-based compensation during the three fiscal years before the date on which the company is required to prepare an accounting restatement to correct a material error

Amount required to be sought in recovery: the amount of incentive-based compensation received by an executive that exceeds the amount he or she would have received had the incentive-based compensation been determined based on the restatement (the “excess compensation”)

Amount required to be sought in recovery if incentive-based compensation was paid based on stock price or total shareholder return: companies can use a reasonable estimate of the effect of the restatement to determine the amount

Discretion not to recover: companies can determine not to clawback the excess compensation if the direct expense of enforcing it would exceed the amount to be recovered (but see the disclosure requirements below), or for FPIs, if it would violate home country laws

Disclosure of the policy: the clawback policy is required to be filed as an exhibit to the annual report.

Disclosure of excess compensation after a restatement and clawback efforts, in proxy statement or annual reports: if, during the fiscal year, the company had a restatement that triggered a clawback, or if there was an outstanding balance related to a prior restatement, the company would be required to disclose: (a) the amount of excess compensation based on the restatement and the amount outstanding at the end of the year; (b) the name of each person from whom the company decided not to pursue recovery, the amounts due and the reason why the company is not trying to recover those amounts; and (c) if the amounts are outstanding for more than 180 days, the name of, and the amount due from,

each person at the end of the year

When to expect the listing rules: no later than 90 days following publication of the final rules, to become effective no later than 1 year following publication.

Consequences of non-compliance: subject to delisting

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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