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PubCo Insight: SEC Approves NYSE and Nasdaq Listing Standards Requiring Nearly All Listed Companies to Adopt Dodd-Frank-Compliant Clawback Policies by December 1, 2023 or Risk Delisting

Insights
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Policies would claw back incentive-based compensation erroneously received by covered executives in fiscal periods ending on or after October 2, 2023

On June 9, 2023, the U.S. Securities and Exchange Commission (SEC) approved New York Stock Exchange (NYSE) and Nasdaq Stock Market (Nasdaq) listing standards that require listed companies to adopt, enforce and provide certain disclosures about a new, mandatory company clawback policy.[1] The policy must require the recovery (or "clawback") of certain incentive-based compensation erroneously received by current and former executive officers in the event of a required accounting restatement (either "Big R" or "little r")[2]—regardless of whether any company or executive misconduct led to such restatement—during the three completed fiscal years immediately preceding the determination that a restatement is required.

Based on the effective date of these new listing standards, listed companies—including emerging growth companies (EGCs), smaller reporting companies (SRCs)

and foreign private issuers (FPIs)—will be **required to adopt compliant clawback policies no later than December 1, 2023 or be subject to delisting**. In addition, listed companies must comply with the related SEC filing and disclosure obligations—including the requirement to publicly file a copy of their written clawback policy as an exhibit to their annual report—in their first annual reports and proxy statements required to be filed on or after October 2, 2023.

The listing standards were originally expected to take effect on June 9, 2023, which would have meant a much earlier clawback policy adoption deadline of August 8, 2023. The delayed effective date is a welcome reprieve and will ensure listed companies have sufficient lead time to evaluate the impact of the new listing standards on their executive compensation programs and any existing clawback policies, finalize and implement compliant policies, obtain board-level approval, prepare for the required disclosure obligations and update their internal compliance processes before the December 1 deadline.

In this alert, we:

- Outline important differences between the new Dodd-Frank clawback requirements and the existing executive compensation clawback provisions under Section 304 of the Sarbanes-Oxley Act of 2002 (SOX);
- Highlight the final rule's key compliance dates;
- Recommend critical action items companies may wish to consider undertaking now; and
- Summarize the most significant aspects of the final rule.

For More Information

If you have any questions or would like assistance in complying with the new clawback requirements discussed in this alert, please reach out to your regular Gunderson Dettmer attorney or any member of our Executive Compensation or Public Companies practice teams.

Executive Compensation Clawbacks: Dodd-Frank vs. SOX

While many public companies already have executive compensation clawback policies in place, including policies designed either to satisfy guidelines of institutional investors and other stakeholders or to comply with compensation recoupment standards enacted under SOX Section 304, the new Dodd-Frank clawback rule imposes a number of significant requirements that go beyond the SOX provisions with which many public companies and executives are already familiar. For example (and as discussed in greater detail under *"Final Rule Summary — Essential Questions and Answers"* below):

- ***Covered executives***. Dodd-Frank broadens the scope of covered executive officers beyond just CEOs and CFOs to encompass all current *and former* Section 16 officers.

- ***Recovery trigger events; "no-fault" basis***. Dodd-Frank clawbacks will be triggered by both "Big R" (or "reissuance") restatements as well as less serious "little r" (or "revision") restatements, in each case without regard to whether any company or executive misconduct occurred that resulted in the restatement, or an executive's culpability or involvement in the preparation of the erroneous financial statements.

- ***Recovery period***. Dodd-Frank expands the lookback period to compensation received during the three completed fiscal years immediately preceding the fiscal year in which a determination is made (or should have been made) to restate the prior financials (whereas SOX limits the amount of required recovery to

compensation received during the 12-month period following the filing of the misstated financials).

- ***Board discretion***. Dodd-Frank substantially limits board/compensation committee discretion as to whether to pursue recovery and amounts subject to recovery.

Dodd-Frank Key Compliance Dates at a Glance

- ***Listing standards effective date***. The NYSE and Nasdaq clawback-related listing standards will become effective on **October 2, 2023**.

- ***Clawback policy adoption deadline***. Listed companies must adopt Dodd-Frank-compliant clawback policies within 60 days following the effective date, or no later than **December 1, 2023**, or be subject to delisting.

- ***Timing of clawback financial obligation***. The required clawback policies must apply to all erroneously awarded incentive-based compensation that is "received" (within the meaning of the final rule) by current and former Section 16 officers in **fiscal periods ending on or after October 2, 2023**. This would capture compensation that was granted or awarded *before* October 2, 2023 but that is subject to a performance period that ends after such date.

- ***Clawback filing and disclosure requirements***. Listed companies must comply with the related SEC filing and disclosure obligations—including the requirement to publicly file a copy of their written clawback policy as an exhibit to their annual repo —in their first annual reports and proxy statements required to be filed on or after **October 2, 2023** (for calendar-year-end companies, including EGCs and SRCs, their annual reports and proxy statements filed in the spring of 2024).

Critical Action Items Now

In anticipation of the above deadlines, listed companies may wish to consider taking the following actions now to ensure timely compliance:

- Finalize a plan for board-level approval of a Dodd-Frank-compliant clawback policy by the December 1 deadline.

- Consider updates to compensation (and any other relevant) committee charters to address clawback-related responsibilities.

- Identify the executive officers whose compensation may be subject to recovery.

- Confirm which existing executive compensation arrangements are subject to recovery, and consider whether any amendments are necessary or advisable in light of the final rule.

- Assess alignment of any existing clawback policies with the final rule and identify areas of potential revision. Consider whether to integrate the new requirements into existing clawback policies or create a separate (standalone) Dodd-Frank-compliant policy. Companies are permitted to develop and implement policies more expansive than what is required under the final rule.

- Establish or enhance the necessary controls and procedures to assess materiality with respect to errors in financial reporting, identify restatements that will trigger application of the clawback policy, track compensation of current and former executive officers that may be subject to recovery and calculate any recoverable amounts, and comply with the new clawback-related disclosure obligations.

- Ensure coordination of internal finance/accounting, legal and human resources teams should a restatement arise that triggers application of the clawback policy.

- Continue to familiarize key company constituencies with the new clawback requirements, related stock exchange listing standards and SEC rules, including the board and audit and compensation committees, company personnel who may

be involved in the event of a restatement and clawback scenario, and Section 16 officers whose compensation will be subject to recovery.

Final Rule Summary — Essential Questions and Answers

The following summary highlights the most significant aspects of the final rule and related stock exchange listing standards.

Which issuers are subject to the final rule?

The final rule applies to **nearly all exchange-listed operating companies**, including EGCs, SRCs, FPIs, controlled companies and companies with only listed debt or preferred securities (categories of issuers not typically subject to the SEC's executive compensation rules).

There are no delayed phase-ins, extended Inline XBRL tagging implementation periods or other scaled disclosure accommodations for EGCs or SRCs.

Which executive officers are subject to the clawback policy?

The final rule applies to a broad universe of ***current and former*** "executive officers" that is consistent with the definition of "officer" in Exchange Act Rule 16a-1(f) (i.e., Section 16 officers), which includes the issuer's president, principal financial officer, principal accounting officer (or controller, if there is no principal accounting officer), any vice-president in charge of a principal business unit, division or function (such as sales, administration or finance) and any other person (including executive officers of a parent or subsidiary) who performs significant policymaking functions for the issuer. Executive officers for purposes of the final rule must include, at a minimum, the executive officers identified by the issuer in its Form 10-K or annual proxy statement pursuant to Item 401(b) of Regulation S-K.

Must there be misconduct, fault or responsibility on the part of executive officers in connection with the restatement for their compensation to be clawed back?

All executive officers are subject to the issuer's clawback policy on a **"no-fault" basis**, without regard to whether any issuer or executive misconduct occurred that resulted in the restatement, or their culpability or involvement in the preparation of the erroneous financial statements. Thus, even restatements attributable to an inadvertent error would potentially subject executive officers, including those with no financial reporting responsibility, to a clawback.

For executive officers who were formerly non-executive employees, what compensation is subject to the clawback policy?

Only erroneously awarded "incentive-based compensation" that is "received" by a person (i) after beginning service as an executive officer and (ii) who served as an executive officer at any time during the performance period for such compensation (whether or not such person is serving at the time the erroneously awarded compensation is required to be repaid to the issuer) is subject to recovery. (For a discussion of what qualifies as "incentive-based compensation" and when such compensation is deemed to be "received," see *"Which types of incentive-based compensation are subject to recovery?"* and "*When is IBC 'received'?"* below.)

Recovery of erroneously awarded incentive-based compensation *"received"* while a person was serving in a non-executive capacity prior to becoming an executive officer is *NOT* required. However, awards of incentive-based compensation *granted* to a person before the person becomes an executive officer will be subject to the clawback policy so long as such compensation was "received" by the person at any time during the performance period for such compensation while serving as an executive officer.

Which accounting restatements will trigger application of the clawback policy?

Clawback policies must be triggered "in the event that the issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws"—regardless of whether any issuer or executive misconduct led to such restatement—either:

- to correct an error in previously issued financial statements that is material to the previously issued financial statements *(a so-called **"Big R" or "reissuance" restatement**)*; or

- to correct an error that is *not* material to previously issued financial statements but would result in a material misstatement if the error were corrected, or left uncorrected, in the current period *(a so-called **"little r" or "revision" restatement**)*.

The SEC Chief Accountant has previously expressed concern over the sharp rise in recent years in "little r" restatements as a percentage of total restatements (nearly 76% in 2020, up from approximately 35% in 2005), and has observed that some accounting error materiality analyses "appear to be biased toward supporting an outcome that an error is not material to previously issued financial statements" so as to avoid "Big R" restatements. The final rule's inclusion of "little r" restatements within the scope of accounting restatements requiring a clawback analysis is intended to address the SEC's concerns that issuers could manipulate materiality and restatement determinations to avoid triggering compensation recovery under their clawback policies.

To assist issuers in making materiality determinations, the adopting release cites to existing staff interpretive guidance, specifically Staff Accounting Bulletin (SAB) No. 99, *Materiality* (1999), and SAB No. 108, *Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements* (2006), noting the guidance emphasizes that an issuer's materiality analysis of an identified error must consider the effects of the error not only on the

face of the financial statements but also on the related footnotes, and evaluate all relevant facts and circumstances, including both quantitative and qualitative factors. The SEC expressly notes that one qualitative factor an issuer should consider when making a materiality determination is "whether the misstatement has the effect of increasing management's compensation" (e.g., bonuses or other forms of incentive compensation).

Application of the issuer's clawback policy would *NOT* be triggered by an **"out-of-period adjustment"**—i.e., when the error is immaterial to the previously issued financial statements and the correction of the error is *also immaterial* to the current period—because it is not an "accounting restatement."

Application of the issuer's clawback policy also would *NOT* be triggered by certain types of changes to previously issued financial statements that **do not represent error corrections** under applicable accounting standards, such as retrospective:

- application of a change in accounting principle;
- revision to reportable segment information due to a change in the structure of an issuer's internal organization;
- reclassification due to a discontinued operation;
- application of a change in reporting entity (such as from a reorganization of entities under common control); and
- revision for stock splits, reverse stock splits, stock dividends or other changes in capital structure.

Which types of incentive-based compensation are subject to recovery?

The final rule's definition of "incentive-based compensation" (IBC) does not include all types of incentive compensation. IBC subject to recovery is defined as any incentive compensation, including cash and equity (including stock options awarded as compensation), that is granted, earned or vested based wholly or in part on the attainment of a "financial reporting measure" (FRM).[3]

FRMs are measures that are determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements, and any measures derived wholly or in part therefrom (including non-GAAP financial measures). **The issuer's stock price and total shareholder return (TSR) are also FRMs**.

FRMs may be presented outside the issuer's financial statements (such as in MD&A) and need not be disclosed in an SEC filing. Examples of FRMs include, but are not limited to, revenue, net income, operating income, profitability of one or more reportable segments, EBITDA, liquidity measures and earnings measures (e.g., earnings per share).

Based on this definition, the adopting release provides a non-exclusive list of examples of IBC subject to recovery, including:

- A salary increase earned based wholly or in part on satisfying goals based on or derived from FRMs;

- Cash bonuses paid from a "bonus pool," the size of which is determined based wholly or in part on satisfying goals based on or derived from FRMs;

- Non-equity incentive plan awards earned based wholly or in part on satisfying goals based on or derived from FRMs;

- Restricted stock, restricted stock units (RSUs), stock options and stock appreciation rights (SARs) that are granted or become vested based wholly or in part on satisfying goals based on or derived from FRMs; and

- Proceeds received upon the sale of shares acquired through an incentive plan that were granted or vested based wholly or in part on satisfying goals based on or derived from FRMs.

Also subject to recovery is erroneously awarded IBC contributed to benefit plans (other than tax-qualified retirement plans) on the basis of FRMs, and any earnings accrued thereon, such as long-term disability plans, life insurance plans and supplemental executive retirement plans (SERPs) (see C&DI 121H.04).

Which types of IBC are *not* subject to recovery?

Non-exclusive examples of compensation that would *NOT* be considered IBC include:

- Base salary;

- Discretionary bonuses;

- Bonuses paid solely on the satisfaction of one or more **subjective** standards (e.g., demonstrated leadership) and/or completion of a specified employment period;

- Non-equity incentive plan awards tied solely to **nonfinancial**, **strategic** or **operational** metrics that are not FRMs (e.g., closing a merger, increasing market share, obtaining regulatory approvals, achieving nonfinancial ESG goals); and

- Stock options and other equity awards for which the grant is not contingent on achieving any goal based on or derived from FRMs, and vesting is **contingent solely on completion of a specified employment period** (e.g., purely time-based stock options, restricted stock or RSUs), **and/or attaining one or more nonfinancial reporting measures**. Note that the strike price of an option, on its own, would not make an option IBC (even though the option is only in-the-money when an issuer's stock price is above the strike price).

Further, erroneously awarded IBC contributed to tax-qualified retirement plans is not subject to recovery.

How does an issuer determine the amount of recoverable IBC?

The amount of recoverable IBC (excess IBC) is the amount received by the executive officer based on the erroneous financial statements **in excess of** the amount the executive officer otherwise would have received had the IBC been calculated based on the restated amounts, **computed on a pre-tax basis** (i.e., without respect to tax liabilities that may have been incurred or paid by the executive officer).

The SEC provides the following guidelines for calculating recoverable amounts for certain forms of IBC:

Stock Price/TSR Metrics

For IBC tied to stock price or TSR, where it is not possible to calculate the recoverable amount directly from the information in the accounting restatement, the

recoverable amount must be determined based on the issuer's **reasonable estimates** of the effect of the accounting restatement on the applicable measure (stock price or TSR).

Issuers have flexibility to determine the most appropriate calculation methodology (and underlying assumptions) for those estimates based on their particular facts and circumstances (an event study is not required).

In such cases, the issuer is required to (i) disclose the estimates used, and an explanation of the methodology used for such estimates, in its proxy statement, (ii) create and maintain documentation regarding its analysis and calculation of the estimates and (iii) provide such documentation to the relevant exchange.

Cash Awards

The recoverable amount is the difference between the amount of the cash award (whether payable as a lump sum or over time) that was received and the amount that should have been received after applying the restated FRM.

Stock Options and Other Equity Awards

How an issuer recovers the excess compensation attributable to equity awards depends on the status of the applicable award (whether the awards have been exercised and whether exercised shares remain outstanding):

- *If the shares, options or SARs are still held and unexercised at the time of recovery*, the recoverable amount is the number of securities received in excess of the number that should have been received after applying the restated FRM (or the value of that excess number).

- *If the options or SARs have been exercised but the underlying shares have not yet been sold*, the recoverable amount is the number of shares underlying the excess options or SARs (or the value thereof) (less any exercise price paid for the shares).

- *If the underlying shares have been sold*, the recoverable amount is the sale proceeds received with respect to the excess number of shares (less any exercise price paid for the shares).

Nonqualified Deferred Compensation

The executive officer's account balance or distributions would be reduced by (i) the excess IBC contributed to the nonqualified deferred compensation plan and (ii) the interest or other earnings accrued thereon.

What happens if the same IBC is subject to recovery under both SOX and Dodd-Frank?

In circumstances in which both the Dodd-Frank and SOX clawback (or other duplicative recovery) provisions could provide for recovery of the same IBC, the SEC states in the adopting release that it would be appropriate for the amount the executive officer has already reimbursed the issuer to be credited toward the required recovery under the issuer's Dodd-Frank clawback policy.

However, recovery under Dodd-Frank would not preclude recovery under SOX, to the extent any applicable amounts have not been reimbursed to the issuer.

What time period is covered by the clawback policy in the event of an accounting restatement?

Excess IBC must be subject to recovery if "received" during the **three completed fiscal years** immediately preceding the date on which the issuer "is required to prepare an accounting restatement."

For purposes of determining this three-year lookback period, the date on which the issuer is deemed to be "required to prepare an accounting restatement" is the earlier to occur of:

- the date the issuer's board, a board committee or authorized officer (if board action is not required) concludes, *or reasonably should have concluded*, that the issuer is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws (which may occur before the precise amount of the error has been determined); and

- the date a court, regulator or other legally authorized body directs the issuer to prepare an accounting restatement.

In the case of "Big R/reissuance" restatements, the first date generally is expected to coincide with the date disclosed in the Item 4.02(a) Form 8-K filed to report non-reliance on previously issued financial statements (though neither date is predicated on a Form 8-K, or restated financial statements, having been filed).[4]

The SEC acknowledges in the adopting release that the "reasonably should have concluded" language "creates some risk that the board's conclusions will be subject to litigation" but "believe[s] this risk is acceptable in light of the benefit of deterring issuers from manipulating the timing of their conclusions to avoid or delay a recovery obligation." The SEC further notes that, in applying a reasonableness standard to the determination of the three-year lookback period, "while not dispositive, one factor that an issuer would have to consider carefully would be any notice that it may receive from its independent auditor that previously issued financial statements contain a material error."

The three-year lookback is based on the three most recently completed fiscal years rather than the preceding 36-month period, and includes any applicable transition period resulting from a change in the issuer's fiscal year within or immediately following those three completed fiscal years.

Example

If a calendar-year-end issuer concludes in November 2024 that a restatement of previously issued financial statements is required and files the restated financial statements in January 2025, the clawback policy would apply to IBC "received" in 2021, 2022 and 2023 (and would include any IBC paid in 2024 that was based on 2021, 2022 or 2023 performance measures).

An issuer's obligation to recover excess IBC is **not dependent** on if or when the restated financial statements are filed with the SEC.

When is IBC "received"?

IBC is deemed to be "received" by an executive officer for purposes of triggering the clawback policy in the fiscal period during which the FRM specified in the IBC award is attained, **regardless of when the award is granted, vested or ultimately paid**, and even if the compensation remains subject to additional vesting conditions based on service or nonfinancial reporting measures after the lookback period ends.

In other words, the date of "receipt" of such IBC is tied to the satisfaction of the FRM performance goal, irrespective of applicable vesting, grant or payment dates. An award subject to both time- and performance-based vesting conditions is considered "received" during the fiscal period when the performance metric is satisfied, even if (i) the award is paid after the fiscal period and/or (ii) the award continues to be subject to time-based vesting criteria.

Ministerial acts or other conditions necessary to effect issuance or payment, such as calculating the amount earned or obtaining board or compensation committee approval for payment, do not affect the determination of the date on which IBC is deemed to be "received."

IBC is subject to recovery only to the extent it is "received" while the issuer has a class of securities listed on an exchange. Thus, any IBC award *granted* to an executive officer prior to the issuer's IPO will be subject to recovery so long as the IBC was "received" by the executive officer while the issuer had a class of listed securities. However, IBC *"received"* by an executive officer before the issuer's securities become listed is *NOT* subject to recovery.

Notwithstanding the three-year lookback requirement, **issuers are only required to recoup excess IBC that is "received" by current and former executive officers in *fiscal periods ending on or after October 2, 2023*** (the effective date of the applicable exchange listing standards). Excess IBC "received" on or after this date is recoverable even if it was awarded or "received" prior to the issuer's adoption of its own compliant clawback policy, and regardless of whether the IBC is received pursuant to a pre-existing contract or arrangement, or one entered into after October 2, 2023.

Does an issuer's board of directors have discretion not to pursue recovery of excess IBC?

An issuer's board has exceedingly limited discretion over whether to recover excess IBC. Recovery is **mandatory**, except in three narrowly prescribed circumstances if the fully independent compensation committee (or majority of independent directors serving on the board) determines that it would be **impracticable**:

1. ***Expense of Enforcement***—because the direct expenses paid to third parties (e.g., reasonable legal expenses and consulting fees) to assist in enforcing the clawback

policy would exceed the recoverable amount, after the issuer has made and documented a reasonable attempt at recovery and provided that documentation to the relevant exchange;

1. ***Violation of Home Country Law***—in the case of FPIs, because recovery would violate applicable home country law in effect prior to November 28, 2022, as documented in a legal opinion from home country counsel provided to the relevant exchange; or

1. ***Tax-Qualified Retirement Plan***—because recovery would likely cause an otherwise tax-qualified retirement plan, under which benefits are broadly available to employees of the issuer, to fail to meet the requirements of the Internal Revenue Code.

Any such impracticability determination is subject to review by the relevant exchange.

Issuers that determine to forgo recovery under any of the three impracticability exceptions must provide proxy statement disclosure regarding that determination, as described in more detail below.

There is **no *de minimis* exception to the recoverable amount**.

May the board exercise discretion as to the *means* of recovering excess IBC?

Although issuers generally cannot settle for amounts less than the full recoverable amount (unless they satisfy the conditions that demonstrate recovery is impracticable), they **may exercise discretion with respect to *how* to accomplish recovery**, and may secure recovery through means that are appropriate based on the particular facts and circumstances applicable to the issuer, type of compensation

arrangement and each executive officer who owes a recoverable amount—but only to the extent they complete recovery **“reasonably promptly.”**

The SEC observes that **many different methods of recovery from amounts that might otherwise be or become due to executives may be appropriate in different circumstances**, but declines to offer specific guidance. Such methods may include, without limitation:

- requiring **reimbursement** of IBC previously paid
- **forfeiting** any IBC contribution made under the issuer’s deferred compensation plans
- **canceling** unvested compensation awards
- **offsetting** the recovered amount from any compensation the executive officer may earn or be awarded in the future

The SEC does not define “reasonably promptly” or establish a specific time frame for completion. However, it “recognize[s] that what is reasonable may depend on the additional cost incident to recovery efforts,” and its stated expectation is that “issuers and their directors and officers, in the exercise of their fiduciary duty to safeguard the assets of the issuer (including the time value of any potentially recoverable compensation), will pursue the most appropriate balance of cost and speed in determining the appropriate means to seek recovery.”

In their respective listing standards, NYSE and Nasdaq provide guidance on how they will assess whether an issuer is pursuing recovery “reasonably promptly” that is consistent with the SEC’s stated expectation, as discussed below.

Deferred Repayment Plans Would Not Violate SOX 402 Loan Prohibition

By way of example, the SEC notes that, depending on the particular facts and circumstances, an issuer may be acting reasonably promptly in establishing a deferred payment plan that allows the executive officer to repay owed excess IBC as soon as possible without unreasonable economic hardship to the executive officer, and confirms such plans—if "narrowly tailored to the compensation being recovered and in order to facilitate full payment as promptly as is reasonable under the circumstances"—would not constitute prohibited personal loans under SOX Section 402.

May issuers indemnify or insure executive officers against recovered amounts?

Issuers are **prohibited** from indemnifying executive officers against, or paying or reimbursing the premiums for an insurance policy to cover, losses incurred under the clawback policy.

The SEC notes that such indemnification or reimbursement would also be prohibited through modification to current compensation arrangements or other means that would amount to *de facto* indemnification, such as, for example, by providing an executive a new cash award which the issuer would then "cancel" to effect recovery of outstanding recoverable amounts.

What SEC filing and disclosure obligations apply with respect to issuers' clawback policies?

Clawback Policy Exhibit Requirement

Issuers must file a copy of their written clawback policy as a tagged exhibit to their applicable Exchange Act annual report on Form 10-K or 20-F.

New Annual Report Cover Page Checkboxes

Issuers must indicate via separate checkboxes on the cover page of their annual reports (i) whether the financial statements included in the filing reflect the correction of an error to previously issued financial statements and (ii) whether any of those error corrections are restatements that required a recovery analysis under the issuer's clawback policy. The checkbox requirement is intended to provide greater transparency around "little r" restatements in particular (and easier identification for investors of those that triggered a clawback analysis), as these restatements typically are not disclosed or reported as prominently as "Big R" restatements.

Detailed Disclosure of Recovery Efforts

For U.S. domestic issuers, new Item 402(w) of Regulation S-K will require that if (i) at any time during or after its last completed fiscal year, the issuer completed a restatement that required recovery of excess IBC pursuant to its clawback policy or (ii) there was an outstanding balance as of the end of its last completed fiscal year of excess IBC to be recovered from the application of that policy to a prior restatement, the issuer must disclose the following information in annual reports and proxy statements that include Item 402 executive compensation disclosure, as relevant:

- the date on which the issuer was required to prepare the restatement, and the **aggregate dollar amount of excess IBC attributable to the restatement (including an analysis of how the recoverable amount was calculated)**; or, if the clawback amount has not yet been determined, an explanation of the reasons why it has not, and subsequent disclosure in the next filing that is subject to Item 402;

- **if the compensation is related to a stock price or TSR metric**, the estimates used in determining the amount of excess IBC attributable to the restatement and an explanation of the methodology used for such estimates;

- the **aggregate dollar amount of excess IBC that remained outstanding** at the end of the issuer's last completed fiscal year;

- **where the issuer is invoking an impracticability exception**, for each current and former named executive officer (NEO) (on an individual basis) and for all other current and former executive officers as a group (on an aggregate basis), the amount of recovery forgone and a brief description of the reason(s) the issuer decided in each case not to pursue recovery, as well as (to the extent applicable to the invoked impracticability exception) a brief explanation of the types of direct expenses paid to a third party to assist in enforcing the clawback policy; identification of the provision of foreign law the clawback policy would violate; or a brief explanation how the clawback policy would cause an otherwise tax-qualified retirement plan to fail to meet the requirements of the Internal Revenue Code;

- the name of, and amount due from, each current and former NEO from whom, as of the end of the issuer's last completed fiscal year, **excess IBC had been outstanding for 180 days or longer** since the date the issuer determined the amount owed; and

- if a restatement was prepared, but the issuer concluded that recovery was not required pursuant to its clawback policy, it must briefly explain **why recovery was not required**.

FPIs will be required to disclose the same information called for by Item 402(w) in their annual reports on Form 20-F.

SCT Adjustments

Recovered amounts must be deducted from the applicable column and total column of the Summary Compensation Table for the fiscal year in which the amount recovered initially was reported as compensation, and identified in a footnote to the table.

Disclosure Location

The Item 402(w) disclosure may be included within or outside the issuer's Compensation Discussion and Analysis (CD&A) (though where clawbacks impact the Summary Compensation Table, it should be addressed in the CD&A).

Interplay with S-K Item 404(a)

To avoid duplicative disclosure, disclosure provided pursuant to Item 402(w) obviates the need to also disclose the recovery of excess IBC pursuant to the related-person transaction disclosure requirements in Regulation S-K Item 404(a).

Incorporation by Reference

The Item 402(w) disclosure will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, except to the extent the issuer specifically incorporates it by reference.

Inline XBRL

Specific data points and block text included within the clawback disclosures must be tagged using Inline XBRL, including the two new cover page checkboxes.

What are the consequences of failure to comply with the final rule?

An issuer will be **subject to suspension of trading and delisting** if it does not adopt, enforce or disclose a compliant clawback policy in accordance with the applicable exchange listing standards and SEC rules.

The applicable exchange is required to determine whether the steps taken by an issuer constitute compliance with its clawback policy.

The NYSE and Nasdaq clawback-related listing standards establish the following delisting procedures in the event of noncompliance:

NYSE Delisting Procedures

- New Section 303A.14 of the NYSE Listed Company Manual prohibits the initial or continued listing of any security of an issuer that is not in compliance with the clawback rule.

- Under new Section 802.01F(b), if an issuer fails to comply with any requirement set forth in the clawback rule (e.g., failure to timely adopt a compliant clawback policy, to recover excess IBC reasonably promptly after a clawback obligation arises or to provide the required disclosures in the applicable SEC filings), the issuer will be required to notify the NYSE in writing within five days of any such failure, and to issue a press release disclosing the failure to comply, the reason for the failure and, if known, the anticipated date by which the failure will be cured.

- NYSE rules provide for a maximum of two consecutive six-month cure periods during which the issuer's securities may continue to be traded; however, NYSE retains sole discretion to impose a shorter cure period or afford no cure period at all and to initiate suspension and delisting procedures at any time following an issuer's

failure to comply with any requirement set forth in the clawback rule. An issuer's failure to regain compliance within one year will result in immediate suspension of trading and commencement of delisting procedures.

Nasdaq Delisting Procedures

- New Nasdaq Listing Rule 5608 requires issuers to adopt a compliant clawback policy, comply with the policy and provide the required disclosures in the applicable SEC filings or be subject to delisting.

- Under amended Listing Rule 5810, within four business days of receiving a notice of deficiency from Nasdaq, a noncompliant issuer must issue a press release disclosing the deficiency. The press release must address the specific concerns cited by Nasdaq and identify the rules upon which the deficiency is based.

- A noncompliant issuer must submit to Nasdaq a plan for regaining compliance within 45 days, and will be afforded up to 180 days to cure the deficiency. Nasdaq must issue a delisting letter immediately following such 180-day cure period if the issuer remains noncompliant. Upon appeal, Nasdaq could allow up to an additional 180 days to cure the deficiency.

How NYSE and Nasdaq Will Assess Whether a Listed Issuer Is Pursuing Recovery "Reasonably Promptly"

In their respective listing standards, both NYSE and Nasdaq include the following language:

"The issuer's obligation to recover erroneously awarded incentive-based compensation reasonably promptly will be assessed on a holistic basis with respect to each such accounting restatement prepared by the issuer. In evaluating whether an issuer is recovering erroneously awarded incentive-based compensation reasonably promptly, the Exchange will consider whether the issuer is pursuing an

appropriate balance of cost and speed in determining the appropriate means to seek recovery, and whether the issuer is securing recovery through means that are appropriate based on the particular facts and circumstances of each executive officer that owes a recoverable amount."

Additional Resources

- Final Rule
- Fact Sheet
- Press Release
- Small Entity Compliance Guide
- Clawback-Related C&DIs Section 121H
- NYSE Clawback Listing Standards
  - SEC Approval Order—NYSE
- Nasdaq Clawback Listing Standards
  - SEC Approval Order—Nasdaq

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[1] U.S. stock exchanges were directed to establish the clawback-related listing standards by Rule 10D-1 under the Securities Exchange Act of 1934 (Exchange Act), as mandated by Section 954 of the Dodd-Frank Act, which the SEC adopted in October 2022 (referred to herein as the "final rule").
[2] For a discussion of the two types of restatements, see *"Which accounting restatements will trigger application of the clawback policy?"* below.
[3] The SEC notes that "in part" is included in the definition to clarify that IBC need not be based *solely* on attainment of an FRM. An example of compensation that is based in part on the attainment of an FRM would include an award in which 60% of the target amount is earned if a certain revenue level is achieved, and 40% of the target amount is earned if a certain number of new stores are opened. Similarly, an

award for which the amount earned is based on attainment of an FRM but is subject to subsequent discretion by the compensation committee to either increase or decrease the amount would be based in part on attainment of the FRM.
[4] In contrast, a “little r” restatement generally does not trigger a Form 8-K filing or require the issuer to amend its filings promptly to restate the previously issued financial statements, and SAB No. 108 notes that the issuer may make any corrections “the next time [it] files the prior year financial statements.”

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