
July 9, 2015

SEC Proposes Executive Compensation Clawback Rules

On July 1, 2015, as mandated by Section 954 of the Dodd-Frank Act, the U.S. Securities and Exchange Commission (the “Commission”) voted 3-to-2 to propose new Rule 10D-1 under the Securities Exchange Act of 1934 (the “Exchange Act”) requiring listed companies to (i) adopt and comply with written compensation clawback policies for executive officers and (ii) disclose these clawback policies in accordance with Commission rules. The proposed clawback rules would implement the last remaining executive compensation provision of the Dodd-Frank Act for which rules have not yet been proposed.

The proposed rules would apply to all companies listed in the United States except for certain registered investment companies. As proposed, emerging growth companies, smaller reporting companies, controlled companies and foreign private issuers (including MJDS issuers) would be subject to the rules.

Proposed Clawback Requirement

Proposed Rule 10D-1 would require national securities exchanges and associations to establish listing standards that would require all listed companies to adopt and comply with compensation recovery (or “clawback”) policies. Recovery would be required from current and former executive officers who received incentive-based compensation during the three fiscal years preceding the date on which the company is required to prepare an accounting restatement to correct a material error. The recovery would be required on a “no fault” basis, without regard to whether any misconduct occurred or to an executive officer’s responsibility for the erroneous financial statements.

Under the proposed rules, companies would be required to recover the amount of incentive-based compensation that exceeds the amount the executive officer would have received during the applicable period had the incentive-based compensation been determined based on the restated financial statements. The recoverable amount would be calculated on a pre-tax basis.

The Commission explicitly did not propose to describe any type or characteristic of an error that would constitute a “material error” for purposes of the proposed clawback requirement. However, certain restatements, including restatements due to changes in accounting principles, certain internal restructurings, certain adjustments in connection with business combinations and revisions due to stock splits, would not be considered corrections of material errors triggering clawbacks.

The Commission noted in the proposing release that the unqualified “no-fault” recovery mandate of the clawback provisions means that companies would be required to pursue recovery in most instances.

However, companies would have limited discretion not to recover the excess incentive-based compensation received by executive officers if the direct expense of enforcing recovery would exceed the amount to be recovered or, for foreign private issuers, in specified circumstances where recovery would violate home country law.

Incentive-Based Compensation

As proposed, “incentive-based compensation” is defined as “any compensation that is granted, earned or vested based wholly or in part upon the attainment of any financial reporting measure.” “Financial reporting measures” are measures that are determined and presented in accordance with the accounting principles used in preparing the company’s financial statements, any measures derived wholly or in part from such financial information, and stock price and total shareholder return. Certain compensation, such as bonuses paid solely upon satisfying one or more subjective standards, non-equity incentive plan awards earned solely upon satisfying one or more strategic measures, and awards that are granted, earned or vest solely upon the occurrence of non-financial events would not be considered incentive-based compensation.

Under the proposed rules, incentive-based compensation would be deemed received in the fiscal period during which the financial reporting measure specified in the incentive-based compensation award is attained, even if the payment or grant occurs after the end of that period. Under this standard, the date of receipt would depend upon the terms of the award. If the grant of an award is based, either wholly or in part, on satisfaction of a financial reporting measure, the award would be deemed received in the fiscal period when that measure was satisfied. If an equity award vests upon satisfaction of a financial reporting measure, the award would be deemed received in the fiscal period when it vests.

For incentive-based compensation based on stock price or total shareholder return, companies could use a reasonable estimate of the effect of the restatement on the applicable measure to determine the amount to be recovered.

Executive Officers Subject to Clawback Provisions

Proposed Rule 10D-1 would apply to current and former executive officers of listed companies. The definition of “executive officer” included in the proposed rules is modeled on the definition of “officer” under Section 16 under the Exchange Act and includes the company’s president, principal financial officer, principal accounting officer, any vice-president in charge of a principal business unit, division or function, and any other person who performs policy-making functions for the company. Notably, this definition is significantly broader than that contained in the clawback provision set forth in Section 304 of the Sarbanes-Oxley Act, which only applies to the chief executive officer and chief financial officer. The proposed rules would prohibit a company from indemnifying an executive officer for the loss of

compensation that the officer is required to pay back under the clawback policy, whether directly or indirectly, without regard to fault.

Disclosure Requirements

Each listed company would be required to file its compensation recovery policy as an exhibit to its Exchange Act annual report. In addition, if during its last completed fiscal year the company either prepared a restatement that required recovery of excess incentive-based compensation, or there were an outstanding balance of excess incentive-based compensation relating to a prior restatement, the company would be required to disclose:

- the date on which it was required to prepare each accounting restatement;
- the aggregate dollar amount of excess incentive-based compensation attributable to the restatement;
- the aggregate dollar amount that remained outstanding at the end of its last completed fiscal year;
- the name of each person subject to recovery from whom the company decided not to pursue recovery;
- the amounts due from each such person;
- a brief description of the reason the company decided not to pursue recovery; and
- if amounts of excess incentive-based compensation are outstanding for more than 180 days, the name of, and amount due from, each person at the end of the company's last completed fiscal year.

The proposed disclosure would be included along with the listed company's other executive compensation disclosure in annual reports on Forms 10-K, 20-F and 40-F and any proxy or information statements in which executive compensation disclosure is required. Listed companies would also be required to block tag the disclosure in an interactive data format using eXtensible Business Reporting Language (XBRL).

The Commission also proposed amendments to the Summary Compensation Table disclosure requirements. A new instruction to the Summary Compensation Table would require that any amounts recovered pursuant to a listed company's erroneously awarded compensation recovery policy reduce the

amount reported in the applicable column for the fiscal year in which the amount recovered initially was reported, and be identified by footnote.

Effective Dates

The proposed rules require that the exchanges file their proposed listing rules no later than 90 days following the publication of the final version of Rule 10D-1 in the Federal Register. The proposed rules also require the listing rules to become effective no later than one year following the publication date. Based on this requirement, it is unlikely that the new clawback listing standards will be effective before the second half of 2016.

Each listed company would be required to adopt its recovery policy no later than 60 days following the date on which the listing exchange's rule becomes effective, and would be required to recover all excess incentive-based compensation received by current and former executive officers on or after the effective date of Rule 10D-1 for any fiscal period ending on or after the effective date of the rule. Listed companies would also be required to comply with the new disclosure requirements in proxy or information statements and Exchange Act annual reports filed on or after the effective date of the listing exchange's rule.

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The SEC will continue to solicit comments on the proposed rules discussed above until 60 days following their publication in the Federal Register. For a copy of the proposed rules, see:

<http://www.sec.gov/rules/proposed/2015/33-9861.pdf>.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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