



Executives, Beware: Your Pay Could Be On the Line

5 STEPS YOU SHOULD TAKE TO ADDRESS NEW CLAWBACK RULES

Insights

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Executives at public and private companies will soon run the risk of having their compensation subject to forfeiture for financial misstatements and corporate criminal misconduct under their watch thanks to new “clawback” rules from the federal government. The new public company clawback standards– proposed in January and expected to take effect this December – are being issued by the NYSE and NASDAQ as required by the Securities and Exchange Commission with a complimentary program in effect for both public and private companies behind the full weight and force of the U.S. Department of Justice. At one time solely the province of public company executives, the DOJ program will work to scoop money out of the pockets of private company leaders. What are the five steps you should take to address these new clawback rules?

Quick Background

Public companies are no strangers to clawback policies. They have been a focus since 2002 when Section 304 of the Sarbanes-Oxley Act came online. That law permits the Securities and Exchange Commission (SEC) to order the clawback of certain incentive-based compensation from CEOs and CFOs – including bonuses or stock sale profits – if the company is required to restate its financial statements due to misconduct.

The importance of clawback policies became a focus again in 2015 under the Dodd-Frank Wall Street Reform and Consumer Protection Act. There the SEC proposed additional clawback rules that once again focused on incentive compensation paid to executives. This time, the rules were expanded to capture situations where financial statements were later restated due to misconduct or other reporting requirement noncompliance.

Now, after 8 years, the SEC has issued final rules scheduled to become effective for public companies in December of 2023. This time, however, the DOJ has changed the game by bringing private companies along with them and dramatically expanding the pool of executives who may soon their wallets take a direct hit due to corporate misconduct.

SEC Final Rules

A key provision of the SEC final rules requires stock exchanges to propose new listing standards implementing rules regarding clawback policies for erroneously awarded incentive compensation. Major components of this final rule include:

- Broad applicability to a listed company's current and former executive officers;
- A prohibition on:
 - Board discretion to base the clawback on a finding of fault on the part of the executive officer;
 - Board discretion not to clawback an amount on the basis of a "de minimis" value determination; and
 - Indemnification agreements;
- Providing that clawback policies must require recovery of erroneously awarded incentive-based compensation received by the company's executive officer during the *three-year period* preceding the date the company's financial statements must be restated due to material noncompliance with financial reporting requirements; and
- Compliance with additional disclosure requirements.

The SEC approved both the New York Stock Exchange's and Nasdaq Stock Market's proposed listing standards on June 9. These standards become effective on October 2. Listed companies will have 60 days to either adopt a compliant clawback policy or amend an existing policy into compliance. **In other words, companies listed on the NYSE or NASDAQ exchanges must have compliant policies no later than December 1, 2023.**

DOJ Clawback Program

The DOJ announced the Criminal Division's clawback policy as a three-year pilot program designed to shift the burden of corporate wrongdoing away from shareholders and onto those who are more directly responsible. The clawback policy applies to both public AND private companies and addresses criminal misconduct of any type, not just financial misstatements.

For example, the DOJ policy would trigger compensation clawbacks in matters involving anti-trust, foreign corrupt practices, corporate fraud, or any other corporate criminal misconduct.

There are two primary components to the program:

- Every corporate resolution involving DOJ's Criminal Division must now include a requirement that requires the company to develop criteria to promote compliance in its compensation and bonus system. Companies will then be required to report annually on the implementation of such criteria.
- The fine might be reduced if the company fully cooperates in the investigation, fully and timely remediates the conduct, and demonstrates it has implemented a clawback policy from

employees who engaged in the criminal wrongdoing under investigation or had supervisory authority over such employees or knew of, or were willfully blind to, the misconduct. Companies may receive a fine reduction even if a good faith attempt to recoup the compensation pursuant to such clawback policy was unsuccessful.

The DOJ Clawback program is currently designed as a three-year pilot program applicable to all corporate matters handled by the DOJ's Criminal Division as of March 15. At the conclusion of the three-year period, the DOJ will determine if the program should be extended or otherwise modified.

5 Key Steps to Address Clawback Rules

The SEC final rules and DOJ clawback policy require careful consideration by corporate executives and companies alike. They provide an opportunity for further tailoring of executive compensation programs and company clawback policies. The five steps you should consider taking to address them:

1. Publicly listed companies should review the relevant listing exchange standards and the DOJ policy for the new clawback policy requirements and amend existing clawback policies or adopt new clawback policies as necessary.
2. They should also evaluate and ensure that all related agreements (including employment agreements, deferred compensation arrangements, and other incentive arrangements) contain appropriate language to enable compliance with such policies.
3. Publicly listed companies must also review the updated disclosure requirements relating to the clawback policies and ensure upcoming filings are compliant.
4. Private companies should consider evaluating existing compensation policies (or adopting new policies) and revising such policies to be in good faith compliance with the DOJ program requirements preemptively.
5. Both public and private companies should educate their Boards and executive management on the new clawback requirements and the potential triggering events.

Conclusion

If you have questions regarding best practices for developing and implementing a compliant compensation clawback program, please reach out to your Fisher Phillips attorney, the authors of this Insight, or any attorney in our [Employee Benefits and Tax Practice Group](#) or [Corporate Compliance and Governance Practice Group](#). Make sure you are [subscribed to Fisher Phillips' Insight System](#) to get the most up-to-date information on this and other employment topics directly to your inbox.

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