

# A Look Inside the SEC's Newly Finalized Clawback Rules

By Bill Hayes



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## Both “Big R” and “Little R” restatements are affected by the Dodd-Frank holdover regulation.

On Oct. 26, 2022, the Securities and Exchange Commission voted to finalize clawback rules, mandated by Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, that direct national stock exchanges to require listed companies to instill policies for recouping bonuses paid to executives of companies found to have inflated financial results. We spoke with Eric Hosken of Compensation Advisory Partners to decipher the biggest differences between current clawback policies and these new regulations, the role of boards in implementing the updated rules, and why it took so long to finalize the first Obama administration.



**Directors & Boards: How do**

**these final rules differ from clawback policies currently in effect at most public companies?**

**Eric Hosken:** The biggest difference is that the final rules mandate the use of the clawback rather than leaving it to board discretion, and they do not require any executive misconduct or malfeasance as part of the clawback trigger. The second-biggest difference is that the rules apply to “little R” restatements that do

not require the amendment of prior-period financial statements or the filing of an 8-K. In practice, this is likely broader than what many companies have as a trigger in their clawback policies. That said, many companies have the ability to claw back in circumstances of executive misconduct that are not even related to a restatement.

**DB: What do you think the role will be for boards and compensation committees as companies work toward implementing these rules?**

**EH:** Boards and compensation committees will have to wait for the listing standards and then review management modifications to the clawback policies to ensure that they are in compliance. Once the new policies are in effect, the board and compensation committee will have the responsibility for actually determining that the clawback policy needs to be applied if there is a restatement, and if prior period incentive compensation needs to be recovered as a result of the restatement. This will require working with legal counsel to determine the ability to recover compensation and to assess whether the direct costs of recovery will be greater than the amounts recovered. In the event that the board or compensation committee determines that the direct cost is greater than the amount to be recovered, they will have to document and disclose this information.

**DB: Do you see any unintended consequences that could come about because of these rules being implemented? How do boards guard against them?**

**EH:** One potential consequence is that companies may be reluctant to do restatements. The audit committee and the external auditor will need to exercise effective control to make sure that companies do restatements when they are necessary based on accounting rules. An additional unintended consequence is that companies may make compensation programs more discretionary so that they do not need to apply a clawback. The clawback applies only to incentive compensation that is determined based on financial performance measures (including total shareholder return or stock price). The clawback would not be triggered for incentive compensation that is determined by board or compensation committee discretion.

**DB: Is it unusual for a rule to be proposed by the SEC in 2015 and for the rule to be finalized in 2022, a seven-year gap? What caused the delay in this case?**

**EH:** The SEC has had different leadership over the intervening period and may not have placed a strong priority on getting the rules implemented. Many of the Dodd-Frank regulations that apply to executive compensation, including the recently finalized pay for performance disclosure rules, were delayed for similar periods of time. These rules are challenging to implement based on the vagueness of the Dodd-Frank language, and it may have been difficult to come to agreement on an approach for implementation.