

# Corporate Crack-Down: SEC Votes to Revive Clawback Rule Stripping Executives Of Their Paychecks

## Labor & Employment Law Update

on November 3, 2021



The executive compensation clawback rule mandated by Congress in Section 954 of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), is back. In the event of corporate misconduct, it will enable the SEC to recoup executive compensation (i.e.,

bonuses or other incentive-based pay), regardless of whether the executive was directly involved in or accused of any wrongdoing.

### Section 954 of the Dodd-Frank Act

The U.S. Securities and Exchange Commission (SEC) proposed an initial draft of Section 954 in 2015. Under Section 954, the SEC was to issue rules requiring companies listed on national securities exchanges to create and enforce clawback policies relating to executive compensation. The draft fell dormant shortly after issuance and was not revisited for six years.

### The Revised Rule

On October 14, 2021, the SEC re-opened public comment on the clawback rule and indicated that it seeks to finalize the rule within the next year.

As currently drafted, the clawback rule will apply to all publicly listed companies—including those whose only listed securities are debt securities or preferred stock. Furthermore, it will require companies to implement and enforce clawback policies to be triggered upon restatement of company financials due to any “material noncompliance” with securities laws. More specifically, if triggered, the company will be forced to “claw back” executive compensation previously paid in excess of the executives’ compensation under the revised financial statements.

This would potentially apply to compensation paid to past and present executives in the three (3) fiscal years leading up to the restatement, regardless of whether the misstatement was due to fraud, errors, or any other factors. Executives subject to these new policies would include a broad sweep of personnel, such as the company's president, principal financial officer, principal accounting officer/controller, any vice president in charge of a principal business unit, division, or function; and any other officer or person who performs policymaking decisions and received incentive-based compensation.

There are two situations in which companies may exercise discretion to forego clawing back compensation from executives. Under both situations, recovery of the compensation must be impracticable, either due to (1) the cost of recovery being more than is owed, or (2) the applicable home country laws. Making a determination of impracticability will need to be documented and conducted by a compensation committee.

### **Impact on Companies**

If finalized, companies will be forced to act as judge, jury and executioner. In other words, companies will be responsible for determining when to clawback executive compensation and for actually enforcing its clawback policy. This is burdensome because it exposes companies to claims by the executive, as well as the SEC.

Additionally, if a company fails to comply with or enforce its clawback policy, the company will be subject to de-listing by the national securities exchanges. While the SEC would likely have some input, the national security exchange where the company is listed would be responsible for determining whether the company has made a good faith effort to comply with its policy.

### **What's Next?**

It is anticipated that the SEC will seek to expand its use of the clawback rule by demanding clawbacks of executive compensation in (1) its current actions, and (2) by requiring provisions for clawbacks in private settlements involving financial restatements. In particular, this is based on the understanding that efforts to finalize this rule are part of a broader push by the SEC and the current administration to end corporate malfeasance by enhancing the tools available for penalizing executives and using tools that it has viewed as being "underutilized." The SEC has shifted its stance on the issue in hopes of strengthening the transparency and quality of corporate financial statements, as well as the accountability of corporate executives to investors.

Although it is possible that the rule may not be implemented as it is still under review, there is ample time for this administration to push it through the approval process. Companies should start reviewing whether they will be subject to the clawback rule. If so, companies should evaluate their current policies and determine whether any changes would need to be made to be compliant. In

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doing so, companies should work with experienced labor and employment law counsel to avoid any potential pitfalls and/or issues with such policies.

We will continue to monitor and post on the revived clawback rule throughout the comment period and approval date.

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