

March 9, 2023

NYSE and Nasdaq File Proposed Listing Standards Implementing SEC Clawback Rule

- **Both Proposed Listing Standards Are Closely Aligned With the Requirements of the SEC’s Final Mandatory Clawback Rule Adopted in October 2022**
 - **Listed Issuers Must Adopt Compliant Policies Within 60 Days Following Effectiveness of the Applicable Listing Standards**
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SUMMARY

On February 22, 2023, the New York Stock Exchange (“NYSE”)¹ and the Nasdaq Stock Market (“Nasdaq”)² filed their respective proposed listing standards pursuant to the U.S. Securities and Exchange Commission’s final mandatory clawback rule³ implementing Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and adding Section 10D to the Securities Exchange Act of 1934. The SEC’s final rule directed national securities exchanges and associations that list securities to establish listing standards that require each issuer to develop and implement a policy providing for the recovery, in the event of a required accounting restatement, of incentive-based compensation received by current or former executive officers where that compensation is based on the erroneously reported financial information. The exchanges’ proposed listing standards conform closely to the applicable requirements of Rule 10D-1.

A listed issuer subject to either exchange’s clawback requirement will be required to adopt a compliant clawback policy within 60 days after the applicable exchange’s listing standard has become effective. The policy may be more (but not less) extensive than the final listing standards applicable to it.

BACKGROUND

On October 26, 2022, the SEC adopted a new rule and amendments to implement Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The final rule, which was published in the Federal Register on November 28, 2022, directed national securities exchanges and associations to require policies mandating the recovery or “clawback” of excess incentive-based compensation earned by a current or former executive officer during the three fiscal years preceding a required accounting restatement, including to correct an error that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period. The excess compensation would be based on the amount the executive officer would have received had the incentive-based compensation been determined using the restated financials. The final rule would apply to all listed companies without regard to the types of securities listed, other than certain listed funds, clearing agencies and unit investment trusts.

The final rule required the exchanges to propose conforming listing standards within 90 days following the final rule’s publication. The proposed standards are required to become effective no later than one year after publication of the final rule.⁴

NYSE AND NASDAQ PROPOSED LISTING STANDARDS

NYSE proposes to comply with the SEC’s final rule by adopting proposed new Section 303A.14 of the NYSE Listed Company Manual (the “Manual”), and Nasdaq proposes to comply by adopting Listing Rule 5608.

Executives Subject to Mandatory Clawback

Consistent with the SEC’s final rule, the clawback requirement of each exchange’s proposed listing standard applies to a universe of “executive officers” that is modeled on the definition of “officer” under Section 16 of the Exchange Act, including both current and former executive officers. Recovery would only apply to incentive-based compensation received by a person (i) after beginning service as an executive officer, (ii) if that person served as an executive officer at any time during the recovery period and (iii) while the issuer has a class of securities listed on a national securities exchange or a national securities association.

Incentive-Based Compensation Covered

Each exchange’s clawback requirement applies to “incentive-based compensation,” which is defined to mean *any compensation* that is granted, earned, or vested *based wholly or in part* upon the attainment of *any financial reporting measure*. “Financial reporting measure” is defined as comprising measures that are determined and presented in accordance with the accounting principles used in preparing the issuer’s financial statements, and any measures that are derived wholly or in part from such measures. Stock price and total shareholder return are also financial reporting measures.

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Restatement Triggers

The final rule triggers clawback for both “Big R” restatements and “little r” restatements. The SEC explained in the adopting release that the broader construction encompassing “little r” restatements “addresses concerns that issuers could manipulate materiality and restatement determinations to avoid application of the compensation recovery policy.”

Reflecting the SEC’s final rule, NYSE’s proposed Section 303A.14(c)(1) provides that the applicable clawback requirement is 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, including any required accounting restatement to correct an error in previously issued financial statements that is material to the previously issued financial statements, or that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period.” Nasdaq’s proposed Listing Rule 5608 contains similar language.

Three-Fiscal Year Clawback Period

Clawback under either listing standard would be required for any excess covered compensation *received* during the *three completed fiscal years* immediately preceding *the date the issuer is required to prepare an accounting restatement*. For example, if a calendar year 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 recovery policy would apply to compensation received in 2021, 2022 and 2023.

Both proposed standards deem covered compensation “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 of the incentive-based compensation occurs after the end of that period.”

For this purpose, the date on which an issuer is required to prepare an accounting restatement is, consistent with the SEC’s final rule, the earlier of:

- The date the issuer’s board of directors, a committee of the board of directors, or the officer or officers of the issuer authorized to take such action if board action is not required concludes, or reasonably should have concluded, 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, or
- The date a court, regulator or other legally authorized body directs the issuer to prepare an accounting restatement.

Determination of Excess Compensation

A listed issuer under either exchange’s proposed listing standard would be required to clawback the amount of incentive-based compensation received during the look-back period by the covered executive officer that exceeds the amount of incentive-based compensation that would have been received if it had been determined based on the accounting restatement, without regard to any taxes paid.

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For incentive-based compensation based on stock price or total shareholder return, where the amount of erroneously awarded compensation is not subject to mathematical recalculation directly from the information in an accounting restatement, (i) the amount must be based on a reasonable estimate of the effect of the accounting restatement on the stock price or total shareholder return upon which the incentive-based compensation was received and (ii) the issuer must maintain documentation of the determination of that reasonable estimate and provide such documentation to the applicable exchange.

Exceptions to the Clawback Obligation

Listed issuers under either exchange's clawback requirement would be required to claw back excess covered compensation unless it would be impracticable to do so, which is defined to include only the following three circumstances: (1) the direct expense paid to a third party to assist in enforcing the policy would exceed the amount to be recovered, provided that the issuer must make a reasonable attempt to recover such erroneously awarded compensation, document such reasonable attempt(s) to recover, and provide that documentation to the applicable exchange; (2) in the case of a foreign private issuer, recovery would violate home country law adopted prior to November 28, 2022 and additional conditions are met; or (3) recovery from certain tax-qualified retirement plans would likely cause such plans to fail to meet the statutory requirements for tax exemption.

A determination that clawback is impracticable must also be made by (i) the issuer's "committee of independent directors responsible for executive compensation decisions" (under proposed Section 303A.14(c)(1)(iv)) or the issuer's "Compensation Committee" (under proposed Listing Rule 5608(b)(1)(iv)), or (ii) in the absence of such a committee, a majority of the independent directors serving on the board.

Prohibition on Indemnification

Consistent with the SEC's final rule, issuers under either proposed listing standard will be prohibited from indemnifying any executive officer or former executive officer against the loss of erroneously awarded compensation.

EFFECT OF NONCOMPLIANCE

Boards may not settle for less than the full recovery amount under either proposed listing standard unless they satisfy one of the limited impracticability exceptions described in "Exceptions to the Clawback Obligation" above.

NYSE proposes to adopt new Section 802.01F ("Noncompliance with Section 303A.14 (Erroneously Awarded Compensation)") to establish consequences for noncompliance. Proposed Section 802.01F(a) would provide that, in any case where NYSE determines that a listed issuer has not recovered erroneously awarded compensation as required by its clawback requirement reasonably promptly after such obligation

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is incurred, trading in all listed securities of such listed issuer would be immediately suspended and NYSE would immediately commence delisting procedures with respect to all such listed securities.

Similarly, Nasdaq proposes to require that an issuer will be subject to delisting if it does not (i) adopt a compensation recovery policy that complies with Nasdaq's listing standards, (ii) disclose the policy in accordance with SEC rules or (iii) comply with the policy's recovery provisions. In addition, Nasdaq proposes to amend Listing Rule 5810(c)(2)(A)(iii) to provide that an issuer that failed to comply with proposed Listing Rule 5608 would be required to submit a plan to regain compliance.

ISSUERS SUBJECT TO CLAWBACK REQUIREMENTS

NYSE's and Nasdaq's respective proposed listing standards generally apply to all listed issuers, including emerging growth companies, smaller reporting companies, foreign private issuers (including Canadian MJDS filers) and controlled companies, without regard to the type of security issued, subject to the following limited exemptions.

NYSE: Section 303A.14(d) ("General Exemptions")

The requirements of Section 303A.14 of the Manual do not apply to the listing of:

- A security futures product cleared by a clearing agency that is registered pursuant to section 17A of the Act (15 U.S.C. 78q-1) or that is exempt from the registration requirements of section 17A(b)(7)(A) (15 U.S.C. 78q-1(b)(7)(A));
- A standardized option, as defined in 17 C.F.R. 240.9b-1(a)(4), issued by a clearing agency that is registered pursuant to section 17A of the Act (15 U.S.C. 78q-1);
- Any security issued by a unit investment trust, as defined in 15 U.S.C. 80a-4(2); and
- Any security issued by a management company, as defined in 15 U.S.C. 80a-4(3), that is registered under Section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), if such management company has not awarded incentive-based compensation to any executive officer of the company in any of the last three fiscal years, or in the case of a company that has been listed for less than three fiscal years, since the listing of the company.

Nasdaq: Listing Rule 5608(c) ("General Exemptions")

The requirements of Rule 5608 do not apply to the listing of:

- Any security issued by a unit investment trust, as defined in 15 U.S.C. 80a-4(2); and
- Any security issued by a management company, as defined in 15 U.S.C. 80a-4(3), that is registered under Section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), if such management company has not awarded incentive-based compensation to any executive officer of the company in any of the last three fiscal years, or in the case of a company that has been listed for less than three fiscal years, since the listing of the company.

CLAWBACK RULE COMPLIANCE & DISCLOSURE INTERPRETATIONS (“C&DI”)

On January 27, 2023, the SEC issued its C&DIs relating to the listing standards requirements under Rule 10D-1. Listed below are key takeaways from this first set of C&DIs:

- **C&DI 121H.01.** The form amendments adding check boxes to the cover page of Form 10-K, Form 20-F, and Form 40-F (indicating whether the form includes the correction of an error in previously issued financial statements and a related recovery analysis) are effective January 27, 2023. However, the SEC clarified that it does not expect compliance with the disclosure requirements until issuers are required to have a recovery policy under the applicable exchange listing standard.
- **C&DI 121H.02.** Item 6.F of Form 20-F provides for individualized disclosure for an issuer’s named executive officers. The SEC clarified that foreign private issuers that file on domestic forms and provide executive compensation disclosure under Item 402 of Regulation S-K should provide individualized disclosure for their named executive officers to the extent required by Form 20-F. For foreign private issuers that use Form 20-F, individualized disclosure is required for members of their administrative, supervisory, or management bodies for whom the issuer otherwise provides individualized compensation disclosure in the filing.
- **C&DI 121H.03.** Item B.(19) of Form 40-F provides for individualized disclosure for an issuer’s named executive officers. The SEC clarified that such individualized disclosure is required for executive officers for whom the issuer otherwise provides individualized compensation disclosure in the filing.
- **C&DI 121H.04.** The SEC clarified that the clawback rule is intended to apply broadly. For any plan that takes into account incentive-based compensation (including, for example, long-term disability plans, life insurance plans and supplemental executive retirement plans (SERPs)), an issuer would be expected to claw back the amount contributed to the notional account based on erroneously awarded incentive-based compensation and any earnings accrued to date on that notional amount.

COMPLIANCE TIMELINE

There will be a public comment period of 21 days once the proposed listing standards are published in the Federal Register. The applicable listing standards must be effective no later than one year after publication of the final rule and may be effective earlier.

Listed issuers will be required to comply with the applicable exchange’s clawback requirement within 60 days from the adoption of the proposed listing standard. Compliance is required regardless of whether the contracts under which incentive-based compensation is to be awarded were entered into prior to, on or after the effective date of the listing standard; provided that listed issuers are required to comply with the clawback policy only in respect of excess compensation received on or after the effective date of the applicable listing standard.

Issuers must comply with the required disclosures in the applicable SEC filings required for any proxy or information statements or Exchange Act annual reports filed on or after the date on which any such issuer is required to have a policy under the applicable exchange listing standard.

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ENDNOTES

- ¹ NYSE's proposal is *available at* <https://www.nyse.com/publicdocs/nyse/markets/nyse/rule-filings/filings/2023/SR-NYSE-2023-12.pdf>.
- ² Nasdaq's proposal is *available at* <https://listingcenter.nasdaq.com/assets/rulebook/NASDAQ/filings/SR-NASDAQ-2023-005.pdf>.
- ³ The adopting release, *Listing Standards for Recovery of Erroneously Awarded Compensation* (SEC Release No. 33-11126), is *available at* <https://www.sec.gov/rules/final/2022/33-11126.pdf>.
- ⁴ For more information, see Sullivan & Cromwell, SEC Adopts Final Mandatory Clawback Rules (October 31, 2022), *available at* <https://www.sullcrom.com/files/upload/sc-publication-sec-adopts-final-mandatory-clawback-rules.pdf>.

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