

October 18, 2021

SEC Reopens Comment Period for Clawbacks

Original Proposal in 2015 Would Require Clawback of Excess Incentive-Based Compensation Earned by Executive Officers During the Three Fiscal Years Preceding an Accounting Restatement to Correct for Material Error

SEC Specifically Seeks Comment and Data on Ten Potential Changes to the Original Proposal

SUMMARY

On October 14, 2021, the U.S. Securities and Exchange Commission (the “SEC”) voted unanimously to [reopen a 30-day comment period](#) on proposed rules for stock exchange listing standards for the recovery of compensation that has been erroneously awarded.¹ Stakeholders may submit comments both on the [original proposed rules](#) and on 10 new questions raised by the SEC. The new questions suggest several potential changes under consideration, including expanding the restatements that will require clawback analysis. The SEC also requested quantified estimates or other detailed analysis and supporting data during this comment period.

BACKGROUND

Section 954 of the Dodd-Frank Act

In 2010, Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”) added Section 10D to the Securities Exchange Act of 1934, which calls for the SEC to adopt rules directing national securities exchanges and associations to prohibit the listing of a security the issuer of which does not develop, implement and disclose a policy governing the recovery of erroneously awarded compensation.

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Proposed Rules

In furtherance of this provision of the Dodd-Frank Act, on July 1, 2015 the SEC issued [proposed rules](#) (the “Proposed Rules”) that would instruct national securities exchanges and associations to establish listing standards which would require issuers to:

- Adopt and comply with a compensation recovery policy pursuant to which issuers would recover, on a no-fault basis – without regard to an executive officer’s culpability or involvement in the preparation of the erroneous financial statement at issue – erroneously awarded incentive-based compensation from current and former executive officers received during the three fiscal years preceding the date of an accounting restatement required to correct a material error; and
- Provide disclosure about the recovery of excess incentive-based compensation and its clawback policy.²

Issuers would be required to make specific disclosures in connection with any clawbacks due to accounting restatements, including, for example, the date on which an accounting restatement was required and the aggregate amount of excess incentive-based compensation resulting from such restatement.³ Finally, an issuer would be required to file a copy of the clawback policy with its annual report on Form 10-K.

The Proposed Rules were included in a release published on July 14, 2015 in the Federal Register. The original comment period ended on September 14, 2015. During the original comment period, the SEC received more than 60 comment letters in respect of the Proposed Rules.

In reopening the comment period,⁴ the SEC observed that there have been significant developments relating to clawback policies since Section 954 of the Dodd-Frank Act was enacted in 2010 and the Proposed Rules were issued in 2015.⁵

TOPICS AND DATA SOLICITED IN THE COMMENT PERIOD

The SEC has specifically requested comments on the following 10 areas, which it recognized are interconnected. As part of the inquiry, the SEC also asked stakeholders to consider a broader question: How would changes to the scope of the Proposed Rules affect other aspects of the Proposed Rules?

1. **Expand Scope of “Accounting Restatement”:** The SEC is considering whether “an accounting restatement due to material noncompliance” should be interpreted to include all required restatements made to correct an error in previously issued financial statements. Such an interpretation would capture restatements that are necessary to correct errors not material to the previously issued financial statements, but would result in a material misstatement if (1) left uncorrected in the current report or (2) the error correction was recognized in the current period. These restatements, along with those to correct errors that are material to the previously issued financial statements, would be considered “an accounting restatement due to material noncompliance.” This change would significantly expand the circumstances under which a clawback analysis is required.⁶ The SEC noted that since the 2015 release, stakeholders have expressed concerns about the appropriateness of materiality determinations with respect to identified errors, suggested by some to be the result of attempts by issuers to avoid clawing back compensation.

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2. **Timing of Three-Year Lookback Period:** For purposes of the three-year lookback period, the Proposed Rules would identify the date on which the issuer would be obligated to restate its financials as the earlier of the date of (1) the issuer's board, a committee thereof, or authorized officers (if board action is not required) concludes, or reasonably should have concluded, that the issuer's previously issued financial statements contain a material error, or (2) a legally authorized body directs the issuer to make a restatement in order to correct a material error. In response to concerns that the "reasonably should have concluded" prong adds uncertainty to this determination, the SEC is considering whether a different standard should be used.
3. **Rely on Common Meaning or Defined Terms:** The Proposed Rules included proposed definitions for a number of terms, such as "accounting restatement" and "material noncompliance." Given the existing guidance and literature with respect to accounting restatements – for example, the U.S. GAAP and IFRS puts forward guidance on how to correct accounting financial statement errors – and that the SEC's recovery trigger would incorporate all required restatements to financial statements, during the reopened comment period the SEC will consider whether it should omit the proposed definitions of "accounting restatement" and "material noncompliance" in favor of reliance upon common meaning and existing sources. The SEC also asked commenters to consider, if no definition is supplied for when incentive-based compensation is "received," what guidance the SEC should put forth regarding its meaning.
4. **Identify Restatements on Form 10-K Cover Page:** The SEC is considering whether to add check boxes to the Form 10-K cover page that identify whether (1) the previously issued financial statements included therein include an error correction and (2) any such corrections are restatements that triggered a clawback analysis during the fiscal year. These additions would support the proposed expansion of accounting restatements that require a clawback analysis.
5. **Provide Data on Costs & Benefits of Clawback Policies:** The SEC suggests that the increase in the voluntary adoption and disclosure of clawback policies could influence the potential aggregate costs of the Proposed Rules. For example, some issuers may have policies that already, or could easily be modified to, comply with the Proposed Rules, while other issuers may have policies that materially differ from the Proposed Rules. Therefore, the SEC is seeking data – primarily the costs to issuers in implementing these policies and the costs and benefits to investors – that would enable it to refine its understanding of the costs and benefits of existing clawback policies and how they might shift under the framework contemplated by the Proposed Rules.
6. **Leverage Issuers' Current Materiality Analysis:** The SEC noted that many issuers' materiality assessments already consider whether any misstatement resulted in an increase to management's compensation. Consequently, the SEC is soliciting comments on the extent to which this assessment of any resulting increase in compensation can be leveraged in the determination of the need for and amount of a recovery.
7. **Require Additional Disclosure of the Recoverable Amount:** The SEC had proposed defining the recoverable amount as "the amount of incentive-based compensation received by the executive officer or former executive officer that exceeds the amount of incentive-based compensation that otherwise would have been received had it been determined based on the accounting restatement." After a restatement, as a threshold matter the issuer would recalculate the applicable financial reporting measure and the amount of incentive-based compensation based upon the reporting measure. The SEC notes that there are a number of possible methods to reasonably estimate the effect of an accounting restatement on stock price (and the related measure of total shareholder return) that have varying levels of complexity and cost. In the Proposed Rules, where the amount of erroneously compensation cannot be recalculated directly from the accounting restatement, the issuer would be required to provide underlying documentation to the exchanges, but not to disclose how the recoverable amount is calculated. In reopening

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the comment period, the SEC is seeking comment on whether additional public disclosures should be required.

8. **Treatment of Registered Management Investment Companies:** The SEC is also considering whether there have been any developments in the payment of incentive-based compensation by listed registered management investment companies that could impact how such companies are treated under the rules. For example, the SEC asked whether an investment company's status as being externally, rather than internally, managed should affect the treatment of such companies under the rules.
9. **Expand Inline XBRL:** The SEC has proposed that new compensation recovery disclosures be block-text tagged using XBRL and is considering whether specific data points within the new compensation recovery disclosure should be separately detail tagged using Inline XBRL (in lieu of, or along with, the proposed block-text tagging). The SEC asked stakeholders whether Inline XBRL detail tagging would be valuable.
10. **Other Developments:** Finally, the SEC solicited comments in respect of any additional developments since the original Proposed Rules that it should consider, including any changes in methodologies and estimates used to assess the economic impact of the Proposed Rules.

The comment period will remain open to the public for 30 days following publication of the release in the Federal Register. Comments may be submitted by mail or online through the SEC website. The SEC states that previously submitted comments are not required to be resubmitted and will be considered. However, it is possible that resubmitting comments will have an optic impact. In addition, in light of the new comment period and the questions raised, issuers might consider reviewing their current clawback policies.

CHAIR'S STATEMENT ON THE REOPENING & LOOKING AHEAD

In commending the decision to reopen the comment period, [Chair Gensler stated](#) that the SEC has “an opportunity to strengthen the transparency and quality of corporate financial statements as well as the accountability of corporate executives to their investors.”⁷ Chair Gensler noted that because executives are often compensated based on the performance of their companies, if the underlying metrics on which such compensation is based are not accurate, “an executive may have been paid for meeting certain milestones that the company didn't, in fact, hit.”⁸

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ENDNOTES

- 1 *Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation* (SEC Release No. 33-10998), available at <https://www.sec.gov/rules/proposed/2021/33-10998.pdf>.
- 2 *SEC Proposes Mandatory Compensation Clawbacks*, available at https://www.sullcrom.com/site/Files/Publications/SC_Publication_SEC_Proposes_Mandatory_Compensation_Clawbacks.pdf; see *Fact Sheet – Listing Standards for Recovery of Erroneously Awarded Compensation*, available at <https://www.sec.gov/rules/proposed/2021/33-10998-fact-sheet.pdf>.
- 3 *Id.* at 8-9.
- 4 *Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation* (SEC Release No. 33-10998), available at <https://www.sec.gov/rules/proposed/2021/33-10998.pdf>.
- 5 In a footnote to its recent release, the SEC remarked that an Intelligize search highlights the increasing number of issuers that have adopted a clawback policy (982 in 2015, 1,321 in 2018 and 2,021 in 2020). *Id.* at 6, n.4.
- 6 For purposes of the Section 10D requirement that certain incentive-based compensation be recovered upon an “accounting restatement” resulting from material noncompliance with applicable financial reporting requirements, the SEC proposed defining an “accounting restatement” as “the result of the process of revising previously issued financial statements to reflect the correction of one or more errors that are material to those financial statements.” *Id.* at 7. Under this definition, no recovery would be required where a restatement is needed to correct errors that were not material to the previously issued financial statements, but would result in a material misstatement if (a) left uncorrected in the current report or (b) the error correction was recognized in the current period.
- 7 *Statement on Rules Regarding Clawbacks of Erroneously Awarded Compensation*, available at <https://www.sec.gov/news/public-statement/gensler-clawbacks-2021-10-14>.
- 8 *Id.*

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