

Meridian Compensation Partners

Client Update

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Clawbacks: Proposed SEC Rules Will Apply to Canadian Companies with a U.S. Listing

Many large Canadian companies have adopted a clawback policy as a good governance practice and in anticipation of U.S. rules under Dodd Frank. On July 1st, SEC staff released these proposed clawback rules.



Surprisingly, under the proposed rules, all companies listed on a (U.S.) national securities exchange, **including foreign private issuers**, are required to have a clawback policy. This is a different approach than has been taken with most of the Dodd Frank compensation rules, which do not directly apply to Canadian

companies. If the rules are finalized in their current form, Canadian companies listed on a U.S. exchange will need to adopt a clawback policy that meets the highly technical US rules.

Once the proposed rules are finalized, Canadian companies listed on a U.S. exchange should carefully review their clawback policies, as most Canadian clawback policies will require significant amendments to comply with the U.S. rules. Canadian companies that are not listed on a U.S. exchange also should expect Canadian practice to quickly evolve towards the key features under the U.S. rules.

Proposed Rules

The following are the key features of the proposed rules:

- **Covered Executives:** The proposed rules apply to all current and former Section 16 officers (most of a company's senior executives, not limited to the named executive officers) who earned "incentive" compensation during a three-year "look back period".
- **Trigger Event:** A public company would be required to clawback "excess" incentive compensation earned by a covered executive during the look back period if there is a financial restatement due to a violation of the federal securities laws. Unlike the Sarbanes-Oxley clawback requirement, and many policies currently in place in Canada, the clawback trigger would **not** require misconduct on the part of a covered executive.
- **Look Back Period:** The look back period is the three-year period ending on the earlier of the date that a public company knew or should have known that it would be required to issue restated financial statements or a regulator advised a public company of the need to restate its financial statements.
- **Definition of Incentive Compensation:** The Dodd-Frank Act defines excess incentive-based compensation as "the amount by which incentive compensation previously paid to the executive officer exceeds what would have been paid to the executive officer under the restated financial statements."

This statutory provision appears to limit the scope of the mandatory clawback policy to incentive compensation linked to the achievement of specific financial metrics. However, the SEC staff broadly interpreted this provision to include incentive compensation linked to the achievement of a specific stock price or to total shareholder return (TSR).

- **Calculation of Excess Incentive Compensation:** To determine excess incentive based compensation under this expanded definition, the proposed rules require a public company to “estimate” what the company’s stock price or TSR would have been if it had initially issued correct financial statements using a “reasonable method”. This is perhaps the most challenging aspect of the proposed rules.
- **Mandatory Clawback:** Excess incentive compensation is required to be clawed back from each covered executive, unless:
 - The cost of recovery would exceed the amount subject to clawback.
 - The clawback would violate home country laws of a foreign private issuer – this would not apply in Canada as clawbacks do not violate Canadian law.
- **Listing Standard:** The national securities exchanges and associations are required to adopt a listing standard requiring each listed company to adopt and implement a mandatory clawback policy.
- **Disclosure Requirements:** A company is also required to disclose its clawback policy and to disclose if (1) it recovered excess incentive compensation upon a financial restatement triggering the requirement to recoup such compensation, and (2) it had an outstanding balance in which a covered executive had not repaid upon a trigger event.

Timing: The proposed rules will be open for public comment for 60 days, followed by a period of review by the SEC. Once issued in final form, stock exchanges will have one year to implement the listing requirements. If the SEC issues final rules before year end, then the mandatory clawback policy would become effective sometime during 2016. ***Canadian companies listed on a U.S. stock exchange are advised to monitor the progress of the proposed rules and, if/when they are finalized, to review their clawback policy.*** We will keep you updated on this issue. Meridian’s detailed analysis of the proposed rules can be found here: [SEC Releases Proposed Rule on Mandatory Clawback](#)

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