

EXECUTIVE “EXCESS” INCENTIVE PAY WILL BE SUBJECT TO MANDATORY CLAWBACK

By Bob Romanchek and Donald Kalfen

SOON, PUBLIC COMPANIES WILL BE REQUIRED

to recoup excess incentive pay received by executive officers that was based on erroneous financial statements. Companies will have no discretion. No fault on the part of an executive officer is required for excess incentive pay to be subject to recoupment. This is the upshot of the SEC’s newly adopted Final Rule on the Dodd-Frank mandatory compensation recoupment policy.

The SEC’s action represents a sea change in corporate governance. The majority of large public companies already have in place compensation recoupment policies. However, the vast majority of these policies allow board discretion to determine whether to seek repayment and often limit recoupment to “at fault” executives. Companies will be required to rewrite these recoupment policies to comply with the new SEC requirements.

A Dodd-Frank-compliant recoupment policy will be required to meet certain requirements:

If a listed company is required to prepare a financial restatement due to the company’s material noncompliance of any financial reporting requirement under the securities laws:

- the company must recover (unless recovery is “impractical”),
- “excess” incentive compensation,
- “received” by current or former “executive officers,” and
- during a three-year “look-back period.”

Applicable listed companies. Nearly all companies listed on a national securities exchange will be required to implement Dodd-Frank compliant recoupment policies, including emerging growth companies, smaller reporting companies, controlled companies and foreign private issuers.

Mandatory recovery. Companies will be required to recoup excess incentive compensation received by current and former executive officers during the applicable three-year look-back period, unless impractical. Recovery will be considered impractical when (i) recovery costs exceed recoverable amount, (ii) recovery would violate

home country law of a foreign private issuer or (iii) recovery would be from a tax-qualified retirement plan, which would cause the plan to violate applicable nonalienation requirements.

Determination of excess incentive compensation.

Excess incentive compensation subject to clawback is equal to the excess of:

- The amount of “incentive compensation” received by an executive officer during the applicable three-year look-back period over
- The amount of incentive compensation the executive officer otherwise would have received if the incentive compensation had been determined based on the company’s restated financial statements.

Incentive compensation is any compensation that is **granted, earned or vested** based wholly, or in part, upon the attainment of any “financial reporting measure,” which is limited to (i) measures determined and presented in accordance with the GAAP, (ii) measures derived wholly, or in part, from GAAP measures, (iii) company stock price; and (iv) total shareholder return on company stock.

Incentive compensation does not include any award that is granted, earned or vested based solely upon the occurrence of non-financial reporting measures, such as time-based stock options and restricted stock/RSU awards and performance awards linked to achievement of subjective goals.

Compensation received. Compensation will be considered “received” by an executive officer in the fiscal year during which the financial reporting measure is attained, regardless of whether (i) the determination or certification of such attainment occurs after the end of such fiscal year, (ii) the payment or grant of the compensation occurs after the end of such fiscal year or (iii) the payment remains subject to a substantial risk of forfeiture.

“Executive officer” refers to a company’s president, principal financial officer, principal accounting officer, vice presidents in charge of business units, divisions or functions and any

other officer who performs a policy-making function.

Definition of look-back period. The three-year look-back period is the **three completed fiscal years immediately preceding** the date on which a company is required to prepare an accounting restatement. This date would be the earliest of:

- The date the company’s board of directors or a board committee concludes, or reasonably should have concluded, that the company is required to prepare an accounting restatement due to the material noncompliance of the company with any financial reporting requirement under the securities laws; or
- The date a court, regulator or other legally authorized body directs the company to prepare an accounting restatement.

Fortunately, companies will likely have nine to 15 months before they will need to modify their existing clawback policy or adopt a new compliant clawback policy. However, companies should add the review (or adoption) of a clawback policy to their 2023 meeting calendar and inventory existing clawback policies/provisions in preparation for the upcoming review.



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