Podcast Summary —
Unforeseen Influence of the New Clawback Rules on Compensation
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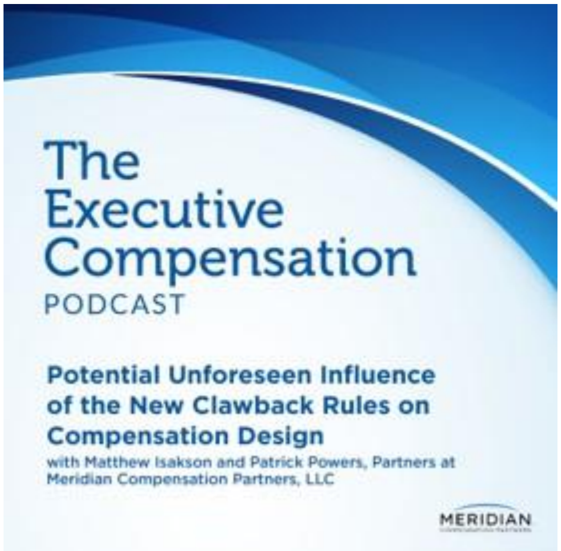

The recent finalization of the SEC's clawback rules, mandated under Dodd-Frank legislation, have raised questions about how these rules might affect broader compensation design. While compliance with the rules has been widely discussed, this podcast explores the potential of unanticipated impacts these rules could have on executive compensation design.

Summary of Key Points:

New Clawback Rules Overview:

The new rules make it mandatory for companies to implement a clawback policy by December 1, 2023. A clawback of previously paid incentives paid within the prior three years can be triggered by any financial restatement, covering both significant and minor restatements. Executives would be required to repay any “excess” incentive compensation that would not have been paid had the restated financial been used to determine payout. The rules apply to Section 16 officers, including former and current officers. There is no requirement for fault in connection with restatements. The clawback rules apply to compensation based on generally accepted accounting principles (GAAP) or GAAP-derived metrics but not to operational or strategic metrics.

Compensation Design Considerations:

- Compensation design should primarily align with a company's business strategy, unique circumstances, and goal-setting.
- Clawback rules, while influential, should not be the primary driver of compensation design.
- Many other factors should have a much greater influence compensation design, including market data, governance expectations, tax regulations, and accounting standards.

Potential Impact of New Rules on Compensation Design:

- *Choice of Vehicles*: There may be a shift towards revisiting the use of stock options, especially premium-priced options, which are not subject to clawback rules.

- *Metric Selection*: Companies may reconsider the metrics used in incentive plans. Metrics further down the income statement may be swapped for simpler ones.
- *Operational Metrics*: Non-financial, operational metrics may become more prominent in incentive plans to mitigate clawback risk.
- Share-Based Metrics: The complexity of calculating clawbacks for share-based metrics, such as TSR, may lead to more cautious use of these metrics.

Recouping Value and Deferred Settlement:

- Companies might consider implementing deferred settlement arrangements, allowing them to recoup value more easily in clawback situations.
- Deferred settlement could mitigate the burden on individuals, but compensation packages might need adjustments to address the illiquidity of deferred payments.

Final Advice:

Follow the regulatory requirements closely. Stick with compliance to the new SEC clawback rules, as this aligns with market expectations. Consider changes to compensation design only after gaining more clarity on the practical implications of the rules in real-world scenarios.

Conclusion:

The new SEC clawback rules, while aimed at ensuring accountability in executive compensation, are unlikely to drastically change compensation design in the corporate world. Instead, they will serve as one of several influencers in the complex landscape of executive pay. Companies should remain cautious, follow the regulations diligently, and evaluate the potential impact on their compensation structures over time. The true influence of these rules will become more evident as companies navigate the complexities of implementing mandatory clawback policies.

Listen to the full podcast here.