

LEGAL UPDATES

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# Preparing for December 1 Compliance with NYSE and Nasdaq Clawback Policy Listing Standards

On June 9, 2023, the Securities and Exchange Commission (SEC) approved the executive compensation clawback listing standards and relevant amendments proposed by the New York Stock Exchange (NYSE) and the Nasdaq Stock Market (Nasdaq). Listed companies will have until December 1, 2023 (60 days after the effective date of October 2, 2023) to adopt a compliant clawback policy. The clawback policies must apply to erroneously awarded incentive-based compensation received on or after October 2, 2023. Related disclosure obligations—such as the obligation to file the clawback policy as an exhibit to the listed company’s annual report—will also become effective on October 2, 2023.

## Background and key components

The Listing Standards were required by new Rule 10D-1, as adopted on October 26, 2022, pursuant to the requirements of Section 10D of the Securities Exchange Act of 1934 (added by Section 954 of the Dodd-Frank Act). Rule 10D-1 requires public companies to implement policies to recover or claw back erroneously awarded incentive-based compensation from current and former executive officers in the event of an accounting restatement, regardless of executive officer fault. A more detailed discussion of the provisions required for clawback policies to comply with new Rule 10D-1 can be found in our prior client alert on the topic.

As required by Rule 10D-1, the NYSE and Nasdaq Listing Standards apply to nearly all companies with listed securities, including smaller reporting companies, emerging growth companies, foreign private issuers, and controlled companies (with limited exceptions). Failure to comply with these Listing Standards (which include notice and cure procedures) leaves

companies subject to immediate suspension and delisting of securities from the exchange.

In addition to requiring the adoption of a written compensation recovery policy that meets the requirements of Rule 10D-1, the NYSE and Nasdaq Listing Standards require listed companies to meet related SEC regulatory requirements to:

file their clawback policies as exhibits to their annual reports (pursuant to Item 601(b)(97) of Regulation S-K),

indicate by check box on the cover of their applicable SEC annual report form whether the financial statements included in the filing reflect correction of an error to previously issued financial statements and whether any of those error corrections are restatements that required analysis under the clawback policy, and

disclose any actions taken pursuant to the clawback policy (such as the adoption of a new policy in accordance with SEC rules) (pursuant to Item 402(w) of Regulation S-K).

Listed companies may not indemnify any executive officer (or former executive officer) against loss of erroneously awarded compensation under the clawback policy, including a prohibition on companies paying for or reimbursing for the cost of any third-party insurance policy intended to fund potential recovery obligations or modifying current compensation arrangements or taking other actions that would amount to de facto indemnification, as discussed in our previous client alert. A review of all existing indemnification arrangements—including those contained in the company's organizational documents, stand-alone agreements or in employment or compensation related agreements—should be conducted to determine whether any amendments are required to comply with this prohibition.

Both the NYSE and Nasdaq have adopted discretionary cure periods if a listed company fails to adopt a recovery policy by the required date or the policy is found not to be in compliance with the new SEC rules and Listing Standards. The NYSE may allow a listed company that fails to comply with the requirements of the Listing Standards an initial six-month period to cure the deficiency. If the deficiency is not cured by the end of the six-month period, the NYSE may allow an additional six months to cure the deficiency; however, the NYSE may decide in its sole discretion (1) not to afford a listed issuer any initial cure period, or (2) at any time during such cure period, to truncate the cure period and immediately commence suspension and delisting procedures.

Similarly, Nasdaq has adopted a cure period of up to 180 days in the case of a listed company that fails to comply with the Listing Standards. Nasdaq may also grant up to an additional 180 days to cure the deficiency at the discretion of the Hearings Panel if a listed company invokes their right to appeal a

delisting process. If a listed company fails to cure their deficiency during the initial cure period, Nasdaq Staff will issue a Staff Delisting Determination, which can be appealed to the Hearings Panel.

## **What this means to you**

Listed companies should finalize a plan for the adoption of a clawback policy that satisfies the applicable Listing Standard by December 1, 2023, by establishing a clawback policy adoption timeline comprised, at a minimum, of the following events:

internal and external review of any existing or new clawback policy,

board communications and final committee and board approvals of a clawback policy that complies with the Listing Standards,

the presentation of clawback policy materials to the board and compensation committees, and

review of disclosure controls and procedures to ensure compliance with the new Listing Standards' disclosure requirements.

A listed company's clawback policy adoption timeline will vary depending on whether the listed company has a pre-existing clawback policy. If a listed company already has an existing clawback policy, it should determine whether to adopt a new stand-alone policy that complies with the Listing Standards (with or without keeping the existing clawback policy) or to integrate the two policies. Regardless of whether the company maintains separate policies or integrates the policies, the documents will need to be drafted to make clear that only compensation required (or voluntarily intended) to be subject to clawback under the Listing Standards is covered by the policy (or the portion of the policy) that applies to all covered executive officers and otherwise meets the requirements of the Listing Standards and Rule 10D-1. When deciding whether to integrate with an existing policy (which for some companies may also cover non-executive employees) or create a new stand-alone policy, companies should consider the new requirement to file the policy as an exhibit to the annual report.

In addition to ensuring the clawback policy complies with SEC rules and the new Listing Standards, listed companies will want to review other internal documents, such as existing compensation agreements, to determine if any provisions are inconsistent with the requirements of the Listing Standards and, if so, amend the agreements as necessary. Potential inconsistencies between a compliant clawback policy and other internal documents include provisions that:

prohibit clawbacks,

trigger clawbacks only in connection with “Big R” accounting restatements, as the Listing Standards and final SEC rules incorporate potential clawback triggers related to both “Big R” and “Little r” restatements,

require clawbacks only in the event of misconduct,

allow board/committee discretion in applying clawbacks,

indemnify executive officers from clawbacks,

require company-paid insurance with respect to recovered compensation, and

reduce clawback recovery for amounts paid in taxes.

Existing incentive compensation practices and existing compensation arrangements should be reviewed to determine whether additional actions are necessary to ensure that the company can properly enforce the new clawback policy and whether it makes sense to alter the structure of the incentive compensation practices that use financial performance measures (including stock price and total shareholder return) for future periods.

Listed companies should determine each of the existing compensation agreements that are subject to clawback under the new Listing Standards and—to the extent not already incorporated into the terms of such agreements in anticipation of the new Listing Standards—seek consents from each of the recipients to the clawback of such compensation when required by the Listing Standard and the company’s newly adopted clawback policy.

A review of the company’s internal control over financial reporting and disclosure controls and procedures should be conducted to make sure that:

triggering events under the clawback policy can be identified in a timely manner,

internal and external resources can be promptly engaged to analyze the situation and its financial and compliance impacts, including making determinations about which current or former executive officers may be affected, the amount of any required clawbacks, and how the company will recover any amounts subject to clawbacks, and

relevant internal and external parties can be promptly informed that a triggering event has occurred and that they will receive all information necessary to comply with the SEC and stock exchange disclosure requirements.

Listed companies also should consider whether it would be beneficial to conduct training sessions to familiarize company personnel (and potentially the company's independent auditors, external legal counsel, and compensation consultants) with the requirements of the clawback policy, SEC rules, and the Listing Standards. Listed companies should consider developing a written playbook that (1) describes the conditions or events that would trigger the company's clawback policy, (2) identifies the relevant parts of the clawback policy, SEC rules, compensation arrangements, and any other applicable materials, (3) describes in sequential order the actions necessary if the company's clawback policy is triggered, and (4) identifies and assigns responsibility to appropriate internal and external persons or functions.

Other considerations for listed companies may include:

updating their compensation committee charters to address clawback responsibilities,

considering whether any new or revised controls and procedures are needed to track compensation of current and former executive officers that may be subject to clawback under the new Listing Standards (as well as maintaining up-to-date address and contact information for former executives whose incentive compensation remains subject to potential clawback), and

reviewing and reconsidering determinations of which employees are designated as officers under Section 16 of the Securities Exchange Act of 1934 to avoid unnecessarily subjecting officers to the new clawback policy.

### **Contact us**

Husch Blackwell's Securities & Corporate Governance team will continue to monitor these changes and their implications. Should you have any questions, please do not hesitate to contact Steve Barrett, Andrew Spector, Ashley Inbau, Robert Fritsche, or your Husch Blackwell attorney.