

Third Time's the Charm? SEC Re-Reopens Comment Period for Executive Comp Clawback Rules

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On June 8, 2022, the Securities and Exchange Commission (SEC) reopened the comment period for its proposed rule implementing the incentive-based compensation recovery (clawback) provisions of the Dodd-Frank Act. The SEC had previously reopened the comment period in October 2021, more than six years after the regulations were first proposed in July 2015, making this newest reopening the third opportunity for interested persons to comment on aspects of the proposed rule.

As discussed in greater detail in our prior article, the proposed rule would require stock exchanges to adopt listing standards mandating public companies to develop and implement clawback policies and make disclosures about them in public filings. Under the proposed rule, all listed companies would be required to have a policy providing for recovery of incentive-based compensation awarded to any current or former executive officer in the three-year period preceding the year in which the company is required to prepare an accounting restatement resulting from material noncompliance with financial reporting requirements. However, the proposed rule was never adopted, and the SEC took no further action until it reopened the comment period in October 2021.

In connection with the current reopening of the comment period, the SEC released a memorandum by the staff of the SEC's Division of Economic and Risk Analysis providing additional analysis and data on clawback policies and accounting restatements (the Staff Memorandum). The SEC stated that it was reopening the comment period in order to allow interested persons to analyze and comment on the findings set forth in the Staff Memorandum.

The Staff Memorandum notes that in the seven years since the proposed regulations were issued, the total number and percentage of public companies disclosing a clawback policy has roughly doubled, with even larger increases among smaller reporting companies, emerging growth companies, foreign private issuers and multijurisdictional disclosure system filers, although several studies indicate that such clawback policies may be more limited in scope than would be required by the proposed rule.

The Staff Memorandum notes that overall, the staff expects that this increase in voluntary adoption of clawback policies may reduce the anticipated benefits, but may also reduce the expected costs, of the proposed rule. First, the staff notes that this increase in voluntary adoption might reduce the anticipated benefits of the clawback regulations (such as increased incentives to improve financial reporting and business practices, and reduced costs of incentive-based compensation) if companies have already adopted strong clawback policies. At the same time, the staff notes that voluntary adoption might also reduce the anticipated costs of the clawback regulations (such as costs of implementation and compliance, and potential shifts in executive compensation). To the extent that companies are already voluntarily disclosing information about their clawback policies, the benefits and costs of the proposed disclosure requirements in the proposed rule would also be mitigated.

As discussed in the October 2021 reopening release, the SEC is considering whether the types of accounting restatements to which the proposed rule would apply should be expanded to include all restatements made to correct an error in previously issued financial statements — including restatements that correct errors that would only result in a material misstatement if the errors were left uncorrected in the current report, or if the error correction was recognized in the current period (commonly referred to as “little r” restatements) — rather than only to restatements that correct errors that resulted in a material misstatement in previously issued financial statements (commonly referred to as “Big R” restatements).

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The Staff Memorandum notes that in 2021, there were roughly three times as many “little r” restatements as “Big R” restatements (excluding restatements by special purpose acquisition companies, or SPACs), and that, as such, if the final clawback rules included both types of restatements, there would be a larger number of restatements that could potentially trigger a clawback. However, the Staff Memorandum also observes that this increase in the number and scope of restatements might not result in a proportionate increase in the number of clawback recoveries, since “little r” restatements may be less likely to trigger a potential clawback of compensation.

As a result, the Staff Memorandum concludes that, while the inclusion of “little r” restatements might increase the anticipated benefits of the clawback regulations (such as having recovered amounts available for other productive uses, and incentivizing high-quality financial reporting and value-enhancing business practices), their inclusion might also increase the costs associated with the clawback regulations (such as costs of implementation and compliance). The Staff Memorandum notes that it is also possible that including “little r” restatements may increase potential incentives for executives to affect financial results

through means that would not trigger compensation recovery, although including “little r” restatements would likely mitigate any incentive for executives to report misstatements as “little r” restatements rather than “Big R” restatements.

The reopened comment period will run until July 14, 2022. Comments may be submitted by mail or by using the SEC’s [online comment form](#). Comments that have been received to date are [available here](#).

As noted in our prior article, the SEC’s timeline for finalizing the clawback regulations remains unclear. Even if the agency adopts final regulations in the very near future, the stock exchanges will need to implement them in new listing standards, which would then require SEC approval. Thus, the effectiveness of the listing standards might potentially occur as late as the first anniversary of the date the SEC finalizes the regulations.

Companies may want to use this time to review their existing clawback policy (or adopt a new policy, as necessary) and should continue to monitor developments with respect to the finalization of the clawback rules.