Guidance on the scope and terms of required clawback policies still remains pending three years after the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Although the statute requires that public companies implement and disclose clawback (recovery) policies that provide for the recoupment of incentive-based compensation upon a required accounting restatement, the lack of rulemaking by the U.S. Securities and Exchange Commission (SEC) has postponed the provision's effective date. In the meantime, corporate governance concerns and numerous issues presented by the statutory language have placed companies in an uncertain position regarding clawbacks.

**Background**

Even prior to Dodd-Frank, clawback policies had been on the rise as a component of good governance. Also, some companies use clawbacks to enforce noncompete and other restrictive covenants in employment agreements.

In addition to such voluntary efforts at compensation recoveries, clawback provisions were included in certain pre-Dodd-Frank legislation. The Sarbanes-Oxley Act of 2002 introduced recoupment requirements that applied to CEOs and CFOs of public firms. Also, clawback requirements applicable to senior executive officers (and certain other highly compensated employees) were a condition for financial organizations to receive an infusion of capital under the Troubled Asset Relief Program (TARP).

The Dodd-Frank clawback standards are considerably broader than under Sarbanes-Oxley or TARP. This includes enforcement through a mandate for the SEC to direct the national securities exchanges to prohibit the listing of a company that does not implement a clawback policy that satisfies the rules adopted by the SEC. Each covered firm also will be required to disclose its clawback policy in its annual proxy statement.

Dodd-Frank provides detailed and complicated requirements for clawback policies. The starting point for a recovery policy is a company's preparation of an accounting restatement, whether or not there was any misconduct by covered executives. Once the clawback policy is triggered, it applies to all incentive-based compensation (including stock options) paid to current and former executive officers. The look-back period for clawback is the three-year period preceding the date of restatement, and the amount subject to recoupment is the difference between the amount paid and the amount that should have been paid under the accounting restatement.

**What to Do While Awaiting SEC Rulemaking**

Regardless of the Dodd-Frank mandate, good governance practices and the desire to obtain favorable recommendations from proxy advisory firms encourage appropriate clawback policies. A few areas to consider while awaiting SEC rulemaking include:

**Review any current clawback language**

A company should review any current clawback language to consider whether it remains appropriate. If a company either does not have a clawback policy or determines that its policy is deficient under good governance standards, a blanket policy may be developed to align the firm's particular circumstances with best practices, at least until SEC rulemaking.

However, until the SEC has adopted rules regarding clawbacks, any policy generally should avoid specificity; the myriad issues presented by the statutory language mean that the final SEC rules undoubtedly will necessitate a reworking of any such policy. Rather
than impose obligations that may be inconsistent with the ultimate SEC guidance, the author favors broad language that tracks the statute and provides that the clawback policy will be updated in a timely fashion to conform with the SEC’s final rules and exchange-listing standards.

Determine people covered by the clawback policy
A company might consider whether any other people should be covered in addition to current and former executive officers. The policy could be applied deeper in an organization, such as to senior finance personnel who may have significant influence on company financial statements and receive incentive awards based on financial measures.

Anticipate impact on incentive plan design and perceived value of compensation
One problem with clawbacks is that employees may discount the perceived value of awards that are subject to recapture. A firm should examine what it needs to communicate with executive officers regarding the potential for the clawback of certain incentive-based compensation.

Taken further, an organization may consider revising its award design to include nonfinancial performance measures that would not be affected by an accounting restatement.

Consider how to recover compensation
Until rules on clawback policies are issued and effective, companies have time to consider what steps may be needed to recover compensation, particularly from former employees. One result may be an increased use of mandatory deferral programs; it is easier to recover funds still in the company’s possession and under its control. To the extent that deferrals are required by employers, an indirect benefit can be the creation of a retention tool. However, any deferral arrangement presents other issues, including compliance with Internal Revenue Code section 409A and the need to include a return opportunity during the deferred period (to avoid erosion of the value of the award).

What to Do Following Rulemaking on Clawback Policies
Once the SEC issues final rules on clawback policies and the exchanges adopt conforming listing standards, companies must be prepared to implement any new or revised clawback policies within the requisite time period. In addition to this necessary regulatory compliance, organizations should consider that, in the current litigious environment regarding executive compensation, any public company that restates its financials and fails to act almost immediately to clawback compensation may face a lawsuit demanding such action.

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