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Executive Compensation Law Alert

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Wall Street Reform Legislation Requires Public Companies to Revise Clawback Policies

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). Although the Act focuses primarily on the financial industry, the Act contains a section that requires the Securities and Exchange Commission ("SEC") to publish rules that direct the national securities exchanges and associations to prohibit the listing of any security of an issuer that does not develop and implement an appropriate clawback policy.

Specifically, a clawback policy must provide that an issuer that is required to restate its financial statements because of a material financial reporting violation must recover from certain executive officers the amount in excess of what would have been paid to them under the issuer's restated financial statements. No showing of misconduct or negligence on the part of the affected executives is required. In other words, public companies must recover the excess, if any, between the actual pay-out under the original financial statements and the amount payable under the restated financial statements. This policy must apply to any current or former executive officer who received incentive-based compensation (including stock options) during the three-year period preceding the date on which the restatement is required. The Act also requires that companies disclose this clawback policy to shareholders. Any former employee who was an executive officer at any time apparently will be subject to the clawback policy without regard to whether he or she was an executive officer at the time of the restatement or whether the compensation that was received had been earned prior to the three-year period.

The clawback provisions under the Act differ from that required of institutions who received financial assistance under the Troubled Asset Relief Program ("TARP"). Institutions that received financial assistance under TARP generally are required to provide for the clawback of bonuses and incentive compensation awarded to senior executive officers and the next 20 highly paid employees if such payments were based on materially inaccurate financial statements or performance metrics, which, depending on the specific circumstances, may have a broader reach than the Act. The Act's provisions also differ from the clawback provisions in Sarbanes-Oxley, which apply only to a company's CEO and CFO, are triggered by misconduct, and apply only to the preceding 12 months.

The effective date of the Act was July 22, 2010; however, the clawback policy requirement is not fully effective until the SEC publishes its regulations. Currently, the SEC is suggesting it will publish these rules to be effective for the 2011 proxy season. As such, no action is needed now, but we recommend that once the final regulations are published, all public companies take the following actions:

1. Examine All Incentive Compensation Arrangement Clawback Policies. All clawback policies need to be revised after the SEC publishes its final rules.

2. Revise and Update Incentive Compensation Plan Design Features. Revising the clawback policy provides an opportunity to review the overall incentive compensation plan design and consider whether it should be revised. For example, some companies have begun to require employees to defer the receipt of incentive awards, in part to ease administration of the clawback policy. Companies must be careful to ensure that any changes are consistent with applicable tax rules.

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