LEGAL ALERT

October 31, 2022

SEC Adopts Rules Implementing Dodd-Frank Act Incentive-Based Compensation Clawback Provisions

On October 26, 2022, the U.S. Securities & Exchange Commission ("SEC") adopted a package of final rules (the "Rules") that implements the provisions of Section 10D of the Securities Exchange Act of 1934 enacted by the Dodd-Frank Consumer Protection and Wall Street Reform Act of 2010 ("Dodd-Frank") which directed the SEC to require national securities exchanges and national securities associations (to the extent such exchange or association lists securities) (each, an "Exchange") to adopt a listing standard mandating that listed companies develop and implement a policy providing for the recovery, in the event of a required accounting restatement, of incentive-based compensation received by current or former executive officers where that compensation is based on the erroneously reported financial information during a three-year lookback period (a "Clawback Policy"). Some key elements of the Rules are:

Effective Date: The Rules become effective 60 days after publication in the Federal Register after which the Exchanges will have 90 days to submit listing standards to the SEC which must become effective no later than one year following publication. Listed issuers will have 60 days from the date the relevant listing standard becomes effective to adopt a Clawback Policy.

Must the Clawback Policy be Filed with the SEC? Yes. Item 601(b) of Regulation S-K has been amended to require the filing of the Clawback Policy as an exhibit to Form 10-K.

Who is Responsible for Adopting the Clawback Policy? Although the Clawback Policy will be adopted by the issuer's Board of Directors, it is recommended that the Audit Committee and Compensation Committee of the Board of Directors, with the assistance of its external auditors and corporate counsel, collaborate in the formulation of a Clawback Policy.

Who is Affected by the Rules? Any issuer which has a class of securities listed on an Exchange. The Rules specifically include Smaller Reporting Companies.

Application of the Rules. The Rules apply when an accounting restatement corrects an error in previously issued financial statements that is material to the previously issued financial statements or that could result in a material misstatement if the error was corrected in the current period or left uncorrected in the current period.

What Triggers a Clawback Policy? If the financial statements of the issuer in a filing on Form 10-K reflect a correction of an error to previously issued financial statements, the issuer will be required to undertake an analysis to determine if the error was material.

Determining Materiality. In the adopting release, the SEC indicated that the issuer's independent auditor should be involved in evaluating management's materiality analysis with the oversight of the issuer's Audit Committee. The SEC also noted that a series of immaterial error corrections could be material when viewed in the aggregate. The adopting release includes examples of changes to financial statements that would not trigger application of a Clawback Policy.

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The SEC has advised that, if the error resulted in increasing management compensation by satisfying the requirements for the award of bonuses or other forms of incentive-based compensation to executive officers, it is a qualitative factor that should be considered when making a materiality determination.

What Types of Incentive-Based Compensation are Subject to the Clawback Policy? The SEC advises that this includes any compensation granted, earned or vested based wholly or in part upon the attainment of any financial reporting measure to which the executive officer would not have been entitled had the issuer's financial statement been presented accurately ("Unjust Compensation"). Financial reporting measures include non-GAAP financial measures under Regulations G and S-K as well as other measures, metrics and ratios that are not non-GAAP measures. Furthermore, these financial measures are not limited to those contained in a SEC filing and could include those presented outside the financial statements such as in the issuer's MD&A or performance graph. Incentive-based compensation tied to stock price and total shareholder return ("TSR") also are included.

From Whom Must the Issuer Clawback Unjust Compensation? Current or former executive officers of the issuer who received the Unjust Compensation during three-year lookback period when the issuer had a class of securities listed on an Exchange.

Who is an Executive Officer? At a minimum, executive officers would include those identified in Item 401(b) of Regulation S-K. However, the definition in the Rules is a bit broader and includes the issuer's president, principal financial officer, principal accounting officer (or if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division, or function (such as sales, administration, or finance), any other officer who performs a significant policy-making function, or any other person who performs similar policy-making functions for the issuer. Executive officers of the issuer's parent(s) or subsidiaries are deemed executive officers of the issuer if they perform such policy making functions for the issuer.

What is the Three-Year Lookback Period? It is the three completed fiscal years immediately preceding the date that the issuer is required to prepare an accounting restatement and, in addition, may include a transitional period resulting from a change of the issuer's fiscal year.

How to Calculate the Three-Year Lookback? For purposes of determining the period for which the issuer must recover the Unjust Enrichment, the relevant date is the earlier of (1) the date the issuer's board of directors, a committee of the board of directors or an officer(s) of the issuer authorized to take such action concludes, or reasonably should have concluded, that the issuer is required to prepare an accounting restatement or (2) the date a court, regulatory or other legally authorized body directs the issuer to prepared an accounting restatement. The date the financial restatement is filed is not relevant.

How is the Amount of Unjust Enrichment to be Recovered Calculated? The amount is the incentive - based compensation received by the executive officer that exceeds the amount of incentive-based compensation that otherwise would have been received had it been determined based on the restated amounts is the amount the issuer is obligated to recover under its Clawback Policy. The amount to be recovered must be computed without regard to any taxes paid.

For incentive-based compensation based on stock price or TSR, where the amount of erroneously awarded compensation is not subject to mathematical recalculation directly from the information in the accounting restatement, the amount must be based on a reasonable estimate of the effect of the accounting restatement on the stock price or TSR upon which the incentive-based compensation was received and the issuer must maintain documentation of that determination and provide the same to the Exchange.

What if the Expense to Recover Outweighs the Unjust Enrichment? The Rules provide that the issuer's Compensation Committee consisting of entirely of independent directors may make a determination that recovery would be impractical if the direct expenses paid to a third party to assist in enforcing the Clawback Policy would exceed the amount to be recovered. However, the issuer must make a reasonable attempt to recover the erroneously awarded compensation, document such attempts and provide that documentation to the Exchange.

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May an Issuer Indemnify an Executive Officer Against Loss under the Clawback Policy? No. The Rules expressly prohibit such indemnification.

What Reporting or Disclosure Obligations Accompany Application of the Clawback Policy? Form 10-K will feature a new checkbox which must be checked if the issuer has applied its Clawback Policy. If the issuer has applied its Clawback Policy, it must provide the disclosures required by new Item 402(w) of Regulation S-K.

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