



**Lowenstein Sandler's Employee Benefits & Executive Compensation Podcast:
Just Compensation**

**Episode 29 –
Clawbacks and Incentive-Based Compensation:
How to Prepare for the New NASDAQ and NYSE
Requirements**

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Kevin Iredell: Welcome to the Lowenstein Sandler podcast series. I'm Kevin Iredell, Chief Marketing Officer at Lowenstein Sandler. Before we begin, please take a moment to subscribe to our podcast series at lowenstein.com/podcasts, or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, SoundCloud, or YouTube. Now let's take a listen.

Jessica Kriegsfeld: Welcome to the latest episode of Just Compensation. My name is Jessica Kriegsfeld and I'm an associate in Lowenstein Sandler's Employee Benefits and Executive Compensation Practice group. I'll turn it over to Kate and Chris to introduce themselves.

Kate Basmagian: Thanks Jess. And my name is Kate Basmagian. I'm a partner in the Capital Markets group and chair of the firm's ESG group.

Christine Osvald-Mruz: Hi, I am Chris Osvald-Mruz. I'm a partner in the Executive Compensation and Employee Benefits group.

Jessica Kriegsfeld: Today's discussion will focus on the new NASDAQ and NYSE clawback policy requirements. To provide a very basic overview, the Security and Exchange Commission, SEC for short, directed NASDAQ and NYSE to impose listing standards that require companies listed on these exchanges to adopt written clawback policies related to incentive-based compensation. On June 9th, 2023, the SEC approved the NASDAQ and NYSE listing standards. The new standards took effect on October 2nd, 2023, and will require listed companies to adopt written clawback policies by December 1st, 2023.

This episode will discuss the new listing standards, what companies must include in their clawback policies, and what companies should do now. As always, this is not intended to be an exhaustive discussion about the application of clawback policies for public companies and is not addressing any additional listing requirements. We encourage you to consult with your legal counsel for the impact on your specific situation. Let's start with the basics. Kate, what's a clawback policy and what do the listing standards require?

Kate Basmagian: So under the listing rules, companies must adopt a clawback policy that would be triggered in the event of a restatement of the company's financials, and this would include both the traditional big R restatement and a little r restatement. And in the event of either of those, the clawback policy would then be triggered and would require that the issuer clawback from the covered executives any erroneously issued

incentive-based compensation. In simpler terms, what this means is if a company issues compensation that is tied to the achievement of financial metrics and then the company has a restatement of its financials, and it turns out that based on the corrected financials, the company executives should have received less of that compensation that was tied to the financial metrics, then the company's required to clawback that excess amount that the executives received. The clawback would also apply to any compensation received by the covered executives and the three completed fiscal years prior to when the company determined they needed to undertake the restatement. And of course, like usual, the application of these policies will be nuanced and we're going to get into all that.

Jessica Kriegsfield: So when did these rules kick in?

Kate Basmagian: Companies are required to have these policies in place by December 1st, 2023, and these rules will apply to any incentive-based compensation received after October 2nd, 2023. The only companies exempted from these rules are issuers of security futures products, standardized options, unit investment trust securities, and certain registered investment company securities.

Jessica Kriegsfield: You mentioned that there are a lot of nuances here. Chris, what's considered incentive-based compensation for purposes of these new listing standards?

Christine Osvald-Mruz: The listing standards define incentive-based compensation as any compensation that is granted, earned, or vested based wholly or in part upon the attainment of a financial reporting measure. Financial reporting measures are generally items presented in the company's financials like revenues, net income, EBITDA, sales, and other metrics derived from those items. The rules have also specified that a company's stock price and its total shareholder return would also be considered financial reporting measures. On the other hand, incentive-based compensation does not include compensation based solely on continued employment such as salaries or discretionary bonuses that are not based on financial reporting measures. It also would not include time-based equity awards such as stock options that vest over time based on continued service only. It also does not include incentive awards based solely on a strategic measure such as closing a merger transaction or solely on an operational measure such as completing a particular project.

Jessica Kriegsfield: What are the rules? When is this incentive-based compensation considered to be received?

Christine Osvald-Mruz: Compensation will be deemed to be received by the executive officer during the fiscal period when the financial reporting measure tied to the incentive-based compensation is attained even if the executive officer is actually paid or granted the incentive-based compensation at a later date. It's important to note here that this may be different from the fiscal year in which the ASC Topic 718 grant date occurs, and for which the award is reported in the summary compensation table.

Jessica Kriegsfield: What amount must be recouped?

Christine Osvald-Mruz: The amount to be recouped is the amount of incentive-based compensation that exceeds the amount that would have been received if it had been determined based on the amounts in the restated financial statements. This amount is also collected on a pre-tax basis. Determining the amount may not be straightforward. For example, for incentive-based compensation that's related to total shareholder return or stock price, the amount must be based on a reasonable estimate of the effect of the accounting restatement on the applicable financial measure.

- Jessica Kriegsfield:** Kate, do these clawback policies apply to all executive officers? What if the executive officers don't have anything to do with preparing the financials and there was no wrongdoing on their part?
- Kate Basmagian:** So the clawback policy must apply at a minimum to all the executive officers that are named in the company's proxy statement. If the clawback policy is ever triggered, it would also apply to any executive officers who served during the three completed fiscal years prior to the restatement, and the policy applies on a no-fault basis. So that's regardless of whether the covered executive was involved in the preparation of the financial statements and the policy would apply even if the executive officer didn't engage in any misconduct related to the financials.
- Jessica Kriegsfield:** Are there any exceptions where the company would have some relief from trying to recoup the erroneously awarded compensation?
- Kate Basmagian:** Yes, there are some exceptions, although they're pretty limited and they are only allowed if recovery under the policy would be impracticable. So one exception would be if the cost of pursuing recovery would exceed the amount of recovery. In this case, the cost considered would be cost paid to a third party to recoup the compensation. Another exception would be if recovery would violate home country law and such laws existed prior to the clawback rules. In this case, the company would need to obtain a legal opinion of home country counsel stating that the recovery would violate home country law. And the rules were also careful to note that inconsistency between the clawback rules and any existing compensation arrangements would not itself be a basis for finding that recovery would be impracticable.
- Jessica Kriegsfield:** Can a company elect to indemnify executive officers?
- Christine Osvald-Mruz:** The short answer to that is no. Listed companies cannot indemnify or reimburse any executive officer for erroneously received compensation and it goes further. Listed companies also cannot pay or reimburse executive officers for paying insurance premiums on a policy that covers potential recovery obligations.
- Jessica Kriegsfield:** What are the ramifications for failing to adopt a callback policy?
- Kate Basmagian:** Companies will be subject to delisting if they don't adopt a policy on time.
- Jessica Kriegsfield:** Are there any additional filing requirements listed companies should be aware of?
- Kate Basmagian:** Yes. So starting with this 2023 fiscal year, companies will be required to file their clawback policy as an exhibit to their 10-K. In addition, companies will also have to indicate on the cover page of their 10-K via a checkbox whether the financial statements included in the 10-K include a restatement that triggered the clawback policy. If a clawback policy is ever triggered, then there will also be some additional disclosures required in the executive compensation section of the company's proxy statement.
- Jessica Kriegsfield:** In light of these new listing standards, what should listed companies do now?
- Kate Basmagian:** So that's a great question. Companies should certainly be identifying the group of covered officers under the policy. In addition, and hopefully most companies out there are already doing this, but companies should also be careful to keep good records related to their incentive-based comp. These records should show what comp was awarded and attributed to what financial performance measures. In the event the clawback policy is ever triggered, this will make life much easier.

Christine Osvald-Mruz: Another immediate thing to do is to draft and approve a compliant clawback policy, or companies should review their existing clawback policies to ensure that they comply. Another fairly immediate suggestion would be to review any existing compensation arrangements and consider whether they're in conflict with the new rules or the clawback policy.

Kate Basmagian: Yeah, and in addition to adopting these policies, companies also need to be able to implement them. To do that, companies should take steps to notify executives of the new rules and the adoption of the policy. It may also be helpful to enter into some kind of acknowledgement with the executives related to the policy. And lastly, companies should also be reviewing their existing indemnification and insurance obligations to ensure there is nothing that conflicts with the new clawback rules.

Jessica Kriegsfield: With the companies should plan to adopt written clawback policies by December 1st, 2023. As mentioned, the new NASDAQ and NYSE listing standards are nuanced. This episode is intended to be a high-level overview of the new listing standards, but it's by no mean an exhaustive discussion of all considerations that may apply to your clawback policy or other listing requirements. We encourage you to consult with counsel about your clawback policy. Thanks for joining us today. We look forward to having you back for our next episode of Just Compensation.

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