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FPI Guide to the SEC's Incentive-based Compensation Clawback Rule

A guide to assist foreign private issuers to implement the new incentive-based compensation recovery (clawback) rule issued by the US Securities and Exchange Commission and the related NYSE and Nasdaq listing standards

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INTRODUCTION

This guide provides foreign private issuers ("**FPIs**") listed in the United States with an overview of Rule 10D-1 under the Securities Exchange Act of 1934, as amended (the "**Exchange Act**") (the "**SEC Clawback Rule**") adopted by the US Securities and Exchange Commission (the "**SEC**") requiring public companies to adopt and enforce policies to recover (clawback) excess incentive-based compensation erroneously received by executive officers in the event of an accounting restatement. The SEC Clawback Rule operates on a no-fault basis and executive officers will be subject to clawback without regard to their personal culpability.

Under the SEC Clawback Rule, subject to limited exceptions, an issuer will be required to recover from current or former executive officers the amount of any incentive-based compensation that is granted, earned, or vested based wholly or in part upon the attainment of a financial reporting measure that exceeds the amount of incentive-based compensation that otherwise would have been received had it been determined based on the restated amounts.

On February 22, 2023, the NYSE and Nasdaq filed with the SEC proposed rules to implement the SEC Clawback Rule (as amended, the "**NYSE Rules**" and the "**Nasdaq Rules**", respectively), which generally replicate the applicable text of the SEC Clawback Rule. The NYSE Rules are in Section 303A.14 and Section 802.01F of the NYSE listing rules and the Nasdaq Rules are in Rule 5608 and 5910(c)(2)(A)(iii) of the Nasdaq listing rules. In response to requests by martket participants to provide listed companies with greater time to comply with the new rules, amendments to the NYSE Rules and the Nasdaq Rules were approved by the SEC on June 9, 2023, and the NYSE Rules and the Nasdaq Rules will become effective on October 2, 2023. This means that listed companies, including FPIs, will be required to adopt a compliant compensation recovery policy (a "**clawback policy**") by **December 1, 2023**.

FPIs that do not currently have a clawback policy should therefore implement a clawback policy by this deadline, and FPIs that do have an existing policy should amend, replace or supplement that policy with a clawback policy that complies with the listing standards of the exchange on which the FPI is listed.

Stock Exchange Implementation of the SEC Clawback Rule	The NYSE Rules and the Nasdaq Rules generally replicate the text of the SEC Clawback Rule. This guide indicates where there are significant differences or additional provisions in the NYSE Rules or the Nasdaq Rules. Therefore, we do not highlight where the NYSE Rules and the Nasdaq Rules adopted the SEC Clawback Rule without modification.

If you have any questions in connection with the contents of this guide, please contact your regular Shearman & Sterling contacts. This guide is provided for general informational purposes only and is not intended as legal, tax or other professional advice, and should not be treated, construed or relied upon as legal, tax or other professional advice. This guide may be considered attorney advertising in some jurisdictions.

BACKGROUND TO THE NEW SEC CLAWBACK RULE

Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**"), a US federal law passed by Congress in 2010 in response to the 2008 global financial crisis, requires the SEC to adopt rules that direct national securities exchanges and associations ("**exchanges**") (which includes the NYSE and Nasdaq) to prohibit the listing of any security of an issuer that does not comply with the requirements of Section 10D of the Exchange Act.

Section 10D of the Exchange Act, as inserted by the Dodd-Frank Act, requires the SEC to direct exchanges to require listed companies to develop and implement a compensation clawback policy for the recovery of erroneously awarded compensation.

On July 1, 2015, the SEC issued a proposed compensation clawback rule to implement the provisions of Section 954 of the Dodd-Frank Act, and the SEC reopened the comment period on that proposed rule on October 14, 2021, and again on June 8, 2022.

On October 26, 2022, the SEC adopted the SEC Clawback Rule to require exchanges to establish listing standards that require listed issuers to:

> adopt and comply with a written policy providing that the issuer will recover reasonably promptly the amount of erroneously awarded incentive-based compensation in the event that the issuer is required to prepare an ***accounting restatement*** due to the ***material noncompliance*** of the issuer with any financial reporting requirement under the securities laws, including any required accounting restatement to correct an error in previously issued financial statements that is material to the previously issued financial statements, or that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period. (***Emphasis added***)

APPLICABILITY TO FOREIGN PRIVATE ISSUERS

The SEC Clawback Rule only applies to issuers of securities listed on a US exchange. Therefore, issuers are not subject to the SEC Clawback Rule if they do not have securities listed on a US exchange and are only subject to SEC reporting obligations for other reasons (such as under Section 15(d) of the Exchange Act in connection with an effective registration statement or issuers subject to mandatory registration under Section 12(g) of the Exchange Act).

Although some exchange listing standards permit FPIs to follow home country practice in lieu of certain corporate governance requirements, the SEC Clawback Rule (and the listing standards required to be issued by exchanges) applies to FPIs, including Canadian issuers using the multijurisdictional disclosure system. The SEC Clawback Rule **does not include exemptions** for emerging growth companies, smaller reporting companies or controlled companies, and exchanges are not permitted to exempt any categories of issuers from the requirements of Section 10D of the Exchange Act.

The SEC Clawback Rule **also applies** to issuers that only have debt or preferred securities listed on a US exchange. The only exempted issuers under SEC Clawback Rule are issuers whose listed securities, are only security futures products, standardized options, unit investment trust securities and certain registered investment company securities.

The SEC Clawback Rule allows exchanges to permit FPIs to forego clawback if an issuer concludes, after having received an opinion of home country counsel acceptable to the relevant exchange, that it is impracticable to recover any amount of erroneously awarded compensation based on violation of home country law that was in effect prior to November 28, 2022, and certain other conditions are met, as described below.

SEC CLAWBACK RULE

The following describes the main provisions of the SEC Clawback Rule.

NYSE	The NYSE Rules do not deviate from the SEC Clawback Rule in relation to which issuers the listing standards apply to.
Nasdaq	The Nasdaq Rules seem to be more restrictive compared to SEC Clawback Rule, as the Nasdaq Rules only exempts issuers of unit investment trust securities and certain securities issued by registered management investment companies (i.e., Nasdaq does not exempt security futures products and standardized options).

Individuals Subject to Clawback Policy

The SEC Clawback Rule applies to all current or former executive officers of an issuer within the clawback period. The SEC Clawback Rule defines "**executive officers**" to include:

- the president;
- the principal financial officer;
- the 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; and
- any other person who performs similar policy-making functions for the issuer.

The SEC Clawback Rule further provides that 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. In addition, when the issuer is a limited partnership, officers, or employees of the general partner(s) who perform policy-making functions for the limited partnership are deemed officers of the limited partnership. When the issuer is a trust, officers, or employees of the trustee(s) who perform policy-making functions for the trust are deemed officers of the trust.

The definition of executive officers under the SEC Clawback Rule tracks the definition of "officer" under Exchange Act Rule 16a-1(f) and therefore captures all "Section 16 officers" of US domestic reporting companies. The SEC Clawback Rule states that the identification of executive officers for the purposes of the SEC Clawback Rule would include at a minimum the executive officers of an issuer identified pursuant to Item 401(b) of Regulation S-K (which requires US domestic reporting companies to identify their executive officers). However, FPIs are not subject to Section 16 of the Exchange Act and are not subject to Item 401(b) of Regulation S-K.

FPIs are currently required to determine who their executive officers are in the following instances:

- **Determining FPI status**: An issuer is required to determine its status as an FPI each year pursuant to Rule 3b-4(c) under the Exchange Act. One component of the FPI test is whether a majority of the issuer's executive officers or directors are US citizens or residents. For the purposes of this test, the term "executive officer" is defined in Rule 3b-7 under the Exchange Act and that definition is substantially similar to (although not as broad as) the definition used in the SEC Clawback Rule.
- **Section 402 of SOX**: FPIs are subject to Section 402 of the Sarbanes-Oxley Act of 2002 ("**SOX**") which, among other things, generally prohibits an issuer from extending or maintaining credit in the form of a personal loan to any director or executive officer (or equivalent thereof) of that issuer. SOX does not define "executive officer" and issuers commonly refer to the definition in Rule 3b-7 under the Exchange Act when making this determination.
- **Form 20-F disclosure of senior management**: Item 1 of Part I of Form 20-F requires FPIs to identify the individuals that comprise their senior management. However, the SEC's final rule release does not refer to senior management. Therefore, when an issuer determines who its executive officers are, it should consider the senior management identified in its Form 20-F, but the issuer's facts and circumstances determination of its executive officers could result in additional individuals being identified as executive officers.

- When preparing and implementing a clawback policy, FPIs will need to determine which positions / individuals are executive officers and therefore subject to the clawback policy.
- Issuers should have a reasonable and objective basis for deciding which individuals perform significant policy-making functions and are therefore executive officers. Issuers should not change the parameters for determining which individuals constitute executive officers in order to achieve a desired result.
- When determining the executive officers to be subject to their clawback policy, FPIs should consider other instances in which FPIs are required to make similar determinations. The definition under the SEC Clawback Rule is different to the other instances described above, and FPIs would be able to deviate from their determinations in other situations, but FPIs should form a reasoned basis for any deviations.

Incentive-based Compensation

The SEC Clawback Rule defines "**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 defined to be:

> measures that are determined and presented in accordance with the ***accounting principles*** used in preparing the issuer's financial statements, and any measures that are derived ***wholly or in part*** from such measures. Stock price and total shareholder return are also financial reporting measures. A financial reporting measure ***need not be presented within*** the financial statements or included in a filing with the Commission. (***Emphasis added***)

Examples of financial reporting measures include (i) GAAP/IFRS financial measures and non-GAAP/IFRS financial measures such as EBITDA, as well as metrics or ratios derived from such measures, (ii) stock price, and (iii) total shareholder return ("**TSR**"). The SEC Clawback Rule expressly includes stock price and TSR as being financial reporting measures. However, neither stock price nor TSR are included in an issuer's financial statements and an accounting restatement would not *directly* change those metrics. In its final rule release, the SEC noted that the final rule "encompasses incentive-based compensation tied to measures such as stock price and TSR because improper accounting affects such financial reporting measures and in turn results in excess compensation".

In its final rule release, the SEC also included the following non-exhaustive examples of compensation that **do constitute** "incentive-based compensation" for the purposes of the SEC Clawback Rule:

- non-equity incentive plan awards that are earned based wholly or in part on satisfying a financial reporting measure performance goal;
- bonuses paid from a "bonus pool," the size of which is determined based wholly or in part on satisfying a financial reporting measure performance goal;
- other cash awards based on satisfaction of a financial reporting measure performance goal;
- restricted stock, restricted stock units, performance share units, stock options, and stock appreciation rights ("**SARs**") that are granted or become vested based wholly or in part on satisfying a financial reporting measure performance goal; and
- proceeds received upon the sale of shares acquired through an incentive plan that were granted or vested based wholly or in part on satisfying a financial reporting measure performance goal.

In its final rule release, the SEC included the following examples of compensation that **do not constitute** "incentive-based compensation" for the purposes of the SEC Clawback Rule:

- salaries;
- bonuses paid solely at the discretion of the compensation committee or board that are not paid from a "bonus pool" that is determined by satisfying a financial reporting measure performance goal;
- bonuses paid solely upon satisfying one or more subjective standards (e.g., demonstrated leadership) and/or completion of a specified employment period;
- non-equity incentive plan awards earned solely upon satisfying one or more **strategic measures** (e.g., consummating a merger or divestiture), or **operational measures** (e.g., opening a specified number of stores, completion of a project, increase in market share); and
- equity awards for which the grant is **not contingent** upon achieving any financial reporting measure performance goal and vesting is contingent solely upon completion of a specified employment period and/or attaining one or more non-financial reporting measures.

It is important to emphasize that the SEC Clawback Rule is not limited to long-term or deferred compensation. Compensation that may trigger recovery under the SEC Clawback Rule includes amounts awarded under long-term incentive plans (such as performance-based equity) or short-term incentive plans (such as cash bonuses) that are granted, vested, or whose size is determined based on a financial metric.

- Issuers should be prepared to demonstrate whether any compensation is incentive-based.
- For example, it would be prudent for issuers to document the decision-making process used and factors considered when determining the size of any bonus pool or other compensatory awards. Documentary evidence as to whether a bonus pool or other compensatory award was determined based upon having satisfied a performance goal based upon a financial reporting measure may be important if an issuer is required to demonstrate this to the SEC or the exchange on which it is listed (or to the executive officers subject to the clawback policy), or in connection with any claims or litigation.

Amount of Erroneously Awarded Compensation Subject to Clawback

The amount of incentive-based compensation that must be subject to the issuer's clawback policy ("**erroneously awarded compensation**") is the amount of incentive-based compensation received by a current or former 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 and must be computed without regard to any taxes paid (i.e., on a **pre-tax basis**). Therefore, an issuer is required to recover the gross amount of the erroneously awarded compensation, **not** the net amount received by the executive officer after payment of taxes. The SEC's final rule release stated that the SEC believes any resulting tax burden should be borne by executive officers, not the issuer and its shareholders.

In the final rule release, the SEC noted that it intends for the definition of erroneously awarded compensation to apply in a **principles-based manner** and as a result issuers may adopt more extensive clawback policies, so long as those policies at a minimum satisfy the requirements of the rule. While the definition is principles-based, the SEC also stated that it believes some guidance would be helpful for issuers. The SEC provided the following guidance:

- For cash awards, the erroneously awarded compensation is the difference between the amount of the cash award (whether payable as a lump sum or over time) that was received and the amount that should have been received applying the restated financial reporting measure.
- For cash awards paid from bonus pools, the erroneously awarded compensation is the *pro rata* portion of any deficiency that results from the aggregate bonus pool that is reduced based on applying the restated financial reporting measure.
  - The SEC provided additional guidance on the application of clawback to bonuses granted under pool plans. "**Pool plans**" are plans in which the size of the available bonus pool is determined based wholly or in part on satisfying a financial reporting measure performance goal with individual grants made under the pool plan being based on board discretion rather than upon the attainment of a performance goal by the individual executive officer. The SEC noted that issuers may not pursue a differential recovery among executive officers. In this instance, the SEC noted that it believes recovery should be *pro rata* based on the size of the original award rather than recovery being discretionary.
- For equity awards, if the shares, options, or stock appreciation rights ("**SARs**") are still held at the time of recovery, the erroneously awarded compensation is the number of such securities received in excess of the number that should have been received applying the restated financial reporting measure (or the value of that excess number). If the options or SARs have been exercised, but the underlying shares have not been sold, the erroneously awarded compensation is the number of shares underlying the excess options or SARs (or the value thereof).

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 an 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 the determination of that reasonable estimate and provide such documentation to the exchange.

In the final rule release, the SEC noted that to reasonably estimate the effect on the stock price, there are a number of possible methods with different levels of complexity of the estimations and related costs. Therefore, issuers will have flexibility to determine the method that is most appropriate based on their facts and circumstances.

- The clawback of erroneously awarded compensation that was awarded based upon a stock price or TSR measure would require the issuer to prepare or obtain a reasonable estimate of what the stock price or TSR would have been "**but for**" the erroneous financial statements.
- Obtaining a reasonable assessment of the impact on the stock price or TSR would, in many cases, may require a complex analysis to be conducted by third-party advisors, which can be expensive. In addition, this assessment can be technical, highly speculative, subjective and imprecise.
- Issuers may take these considerations into account when granting future incentive-based awards that are based in whole or in part on stock price, TSR or similar measures.

Clawback Period

An issuer is required to clawback erroneously awarded compensation that was received (i.e., the date that the financial measure determining the incentive-based compensation was achieved) during the **three completed fiscal years** immediately preceding the date that the issuer is **required** to prepare an accounting restatement. Therefore, an issuer's obligation to recover erroneously awarded compensation is **not dependent on if or when** the restated financial statements are filed.

For example, if an issuer with a December 31 fiscal year end concludes in November 2024 that a restatement of its previously issued financial statements is required and files the restated financial statements in January 2025, the clawback policy would apply to compensation received in 2021, 2022, and 2023.

If an issuer has changed its fiscal year end during the three-year look-back period, the issuer must recover any excess incentive-based compensation received during the transition period occurring during, or immediately following, that three-year period in addition to any excess incentive-based compensation received during the three-year look-back period (i.e., a total of four periods). However, a transition period between the last day of the issuer's previous fiscal year end and the first day of its new fiscal year that comprises a period of nine to 12 months would be deemed a completed fiscal year.

Incentive-based Compensation Subject to Clawback

The issuer's clawback policy must apply to all incentive-based compensation that is:

- **received** by a person **after** beginning service as an executive officer;
- received **while** the issuer has a class of securities listed on an exchange; and
- the executive officer must have served as an executive officer **at any time during the clawback period**.

In addition, an issuer is only required to apply the clawback policy to incentive-based compensation **received after October 2, 2023** (which is the effective date of the exchange listing standards).

The SEC Clawback Rule provides that incentive-based compensation will be deemed to be "**received**" for purposes of the clawback policy in the fiscal period during which the financial reporting measure specified in the incentive-based compensation award is **attained**, even if the **payment** or **grant** occurs after the end of that period.

In the final rule release, the SEC noted that the date of **receipt** of the compensation depends upon the terms of the award. The SEC provided the following examples:

- If the grant of an award is based, either wholly or in part, on satisfaction of a financial reporting measure performance goal, the award would be deemed received in the fiscal period when that measure was satisfied.
- If an equity award vests only upon satisfaction of a financial reporting measure performance condition, the award would be deemed received in the fiscal period when it vests.

- A non-equity incentive plan award would be deemed received in the fiscal year that the executive officer earns the award based on satisfaction of the relevant financial reporting measure performance goal, rather than a subsequent date on which the award was paid.
- A cash award earned upon satisfaction of a financial reporting measure performance goal would be deemed received in the fiscal period when that measure is satisfied.

The SEC believes that the executive officer receives the compensation for purposes of a clawback policy when the relevant financial reporting measure performance goal is attained, even if the executive officer has established only a contingent right to payment at that time. Therefore, if an award is subject to **multiple vesting conditions**, the award is deemed to be received by the executive officer when the **performance goal(s)** tied to financial reporting measures is/are attained, even if the award is contingent upon the occurrence of other events. For example, if an award is subject to time-vesting condition (such as continued service to a specified date), then the award is considered received when the relevant performance goals are obtained, even though the executive officer would only have a contingent right to payment of that award if the executive officer satisfies the time-vesting condition.

Furthermore, ministerial acts or other conditions necessary to effect issuance or payment, such as calculating the amount earned or obtaining the board of directors' approval of payment, do not affect the determination of the date received.

In its final rule release, the SEC provided the following detailed example of the application of the SEC Clawback Rule to an award that is subject to both **performance-based vesting conditions and time-based vesting conditions**:

> For example, an issuer could grant an executive officer restricted stock units in which the number of units earned is determined at the end of the three-year incentive-based performance period (2020-2022), but the award is subject to service-based vesting for two more years (2023-2024). Although the executive officer does not have a non-forfeitable interest in the units before expiration of the subsequent two-year service-based vesting period, the number of shares in which the units ultimately will be paid will be established at the end of the three-year performance period which is when the relevant financial reporting measure performance goal is attained. If the issuer's board of directors concludes in 2023 that the issuer will restate previously issued financial statements for 2020 through 2022 (the three-year performance period), the recovery policy should apply to reduce the number of units ultimately payable in stock, even though the executive officer has not yet satisfied the two-year service-based vesting condition to payment. To the extent that an executive officer fails to then meet the service vesting period and never actually receives the compensation, the compensation forgone as a result of the failure to meet the vesting period would be the reduced compensation as a result of the recovery policy.

Restatement Requiring Clawback

The SEC Clawback Rule applies if:

> the issuer is required to prepare an ***accounting restatement*** due to the ***material noncompliance*** of the issuer with any financial reporting requirement under the securities laws, including any required accounting restatement to correct an error in ***previously issued financial statements*** that is material to the previously issued financial statements, or that would result in a material misstatement if the error were corrected in the ***current period*** or left uncorrected in the current period. (***Emphasis added***)

Therefore, the SEC Clawback Rule applies to both so-called "Big R" and "little r" restatements.

- "**Big R**" **restatements** (also sometimes referred to as **reissuance restatements**) are restatements that correct errors that are material to previously issued financial statements. "Big R" restatements require the issuer to restate and reissue its previously issued financial statements to reflect the correction of the error in those previously issued financial statements.
- "**Little r**" **restatements** (also sometimes referred to as **revision restatements**) are restatements that correct errors that are not material to previously issued financial statements but would result in a material misstatement if (i) the errors were left uncorrected in the current period or (ii) the error correction was recognized in the current period. This often occurs because an immaterial error that has been uncorrected for multiple periods and has aggregated to a material number within the current period. "Little r" restatements require the issuer to correct the error in the current period financial statements by adjusting the prior period information in its current financial statements and adding disclosure of the error (but the prior period financial statements are not reissued).

Out-of-period adjustments are not accounting restatements and do not trigger a compensation recovery analysis under the SEC Clawback Rule. An out-of-period adjustment occurs where an error is corrected in the current period financial statements when the error is immaterial to the previously issued financial statements and the correction of the error is also immaterial to the current period.

Not every restatement is within the scope of the SEC Clawback Rule, which requires the restatement to have been due to the **material noncompliance** of the issuer with any financial reporting requirement under the securities laws. "Material noncompliance" is not defined in the SEC Clawback Rule. In its final rule release, the SEC noted that existing accounting standards and guidance already set out the meaning of such term and the SEC Clawback Rule is not intended to affect that guidance. Therefore, FPIs should look to existing guidance, literature, and definitions when assessing accounting errors and ensure that it applies those standards are consistently over time.

In addition, in the SEC's final rule release, it noted that under current accounting standards the following retrospective changes to prior period financial information would not constitute accounting restatements and therefore do not trigger a compensation recovery under the SEC Clawback Rule:

- retrospective revision to reportable segment information if an issuer's management changes the structure of its internal organization in a manner that causes the composition of its reportable segments to change;
- retrospective reclassification due to a discontinued operations as a result of a disposed or a classification of a component as being held for sale after the date of the relevant financial statements;
- retrospective revision for stock splits, reverse stock splits, stock dividends or other changes in capital structure;
- retrospective application of a change in accounting principles;
- retrospective application of a change in reporting entity, such as from a reorganization of entities under common control; and
- retrospective adjustment to provisional amounts in connection with a prior business combination.

- On June 8, 2022, the Staff of the SEC's Division of Economic and Risk Analysis issued a memorandum which provided data and analysis on, among other things, the impact of including "little r" restatements as triggers for a compensation recovery analysis. Based on 2021 data, the Staff noted that "little r" restatements may account for approximately **three times** as many restatements as "Big R" restatements.
- However, the Staff further noted that "little r" restatements may be **less likely** than "Big R" restatements to trigger a potential recovery of compensation. For example, "little r" restatements may be less likely to be associated with a decline in previously reported net income, and on average they are associated with smaller stock price reactions.

Date for Preparation of Restatement

The SEC Clawback Rule requires that the listing standards of the relevant exchange provide that the date on which an issuer is required to prepare an accounting restatement is the earlier to occur of:

- the date that (i) the issuer's board of directors, (ii) a committee of the board of directors, or (iii) the officer or officers of the issuer authorized to take such action (if board action is not required) **concludes**, or **reasonably should have concluded**, that the issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws; or
- the date a court, regulator or other legally authorized body directs the issuer to prepare an accounting restatement.

"No Fault" Basis and No Issuer Discretion

The statutory recovery mandate under the Dodd-Frank Act is unqualified and applies on a no-fault basis to erroneously awarded compensation. There is no requirement to establish wrongdoing by an executive officer before compensation clawback, and the Dodd-Frank Act does not limit recovery to executive officers who were directly involved with the accounting error. In its final rule release, the SEC noted that it believed Section 10D of the Exchange Act was established not to punish wrongdoing, but to require executive officers to return monies that rightfully belong to the issuer and its shareholders.

In addition, except in the limited circumstances described below, issuers do not have any discretion on whether to enforce their clawback policy.

However, in the final rule release, the SEC notes that issuers are permitted to exercise discretion in **how** to accomplish recovery (e.g., the recovery methods used), as discussed further below.

Exceptions to Clawback

Issuers are required to recover erroneously awarded compensation in compliance with its clawback policy except to the extent one of three limited exceptions applies.

In order for an issuer to apply an exception, the issuer's committee of independent directors responsible for executive compensation decisions, or in the absence of such a committee, a majority of the independent directors serving on the board of directors, must make a determination that recovery would be impracticable.

The three exceptions are as follows:

- If the direct expense paid to a third party to assist in enforcing the policy would exceed the amount to be recovered.
  - For example, if a current or former executive officer is unwilling to return erroneously awarded compensation, the issuer may incur legal expenses to pursue recovery through litigation or arbitration. The SEC also included consulting fees as another example of direct expenses.
  - However, the SEC Clawback Rule provides that, before concluding that it would be impracticable to recover any amount of erroneously awarded compensation based on expense of enforcement, the issuer must make a reasonable attempt to recover such erroneously awarded compensation, document such reasonable attempts to recover, and provide that documentation to the exchange or association.
- If recovery would violate home country law where that law was adopted prior to November 28, 2022 (the date that the SEC Clawback Rule was published in the Federal Register).
  - Before concluding that it would be impracticable to recover any amount of erroneously awarded compensation based on violation of home country law, the issuer must obtain an opinion of home country counsel that recovery would result in a violation of home country law.
  - The legal opinion must be provided to the exchange and must be acceptable to the relevant exchange.
- If recovery would likely cause an otherwise tax-qualified retirement plan, under which benefits are broadly available to employees of the issuer, to fail to meet the requirements of the US Internal Revenue Code.
  - On January 27, 2023, the SEC published the following Compliance and Disclosure Interpretation:

    Question: Because the clawback rule applies broadly to incentive-based compensation, would the rules affect compensation that is in any sort of plan, other than tax-qualified retirement plans, including long term disability, life insurance, SERPs [Supplemental Executive Retirement Plans], or any other compensation that is based on the incentive-based compensation?

    Answer: The rule is intended to apply broadly. For plans that take into account incentive-based compensation, an issuer would be expected to claw back the amount contributed to the notional account based on erroneously awarded incentive-based compensation and any earnings accrued to date on that notional amount.

- Form 20-F defines "**home country**" as the jurisdiction in which the company is legally organized, incorporated or established **and**, if different, the jurisdiction where it has its principal listing.
- An FPI's principal listing is determined pursuant to the definition of "principal market" in Rule 12b-2 under the Exchange Act, which is defined as the single securities market with the largest aggregate reported trading volume for the class of securities during the 12 full calendar months immediately preceding the filing (with the trading volume being calculated to reflect the multiple or fraction of any securities represented by depositary receipts).
- While the home country exception described above would apply to an FPI's jurisdiction of incorporation and the jurisdiction of its principal listing, the home country law exception does not apply to any other jurisdictions in which the FPI operates. For example, **if an FPI is incorporated in a jurisdiction other than the jurisdiction where its executive officers are based**, the home country exception set forth in the SEC Clawback Rule would not appear to apply.
- If an FPI determines that clawback may be prohibited under a jurisdiction where its executive officers are based and such jurisdiction is not the FPI's "home country", the FPI should consider whether the circumstances warrant using its discretion not to pursue recovery in situations in which the direct costs of recovering the erroneously awarded compensation would exceed the amount to be recovered.

Prohibition on Indemnification of Executive Officers for Clawback

The SEC Clawback Rule prohibits issuers from indemnifying any current or former executive officer against the loss of erroneously awarded compensation.

The SEC acknowledged in the proposing rule release that state indemnification statutes, indemnification provisions in an issuer's charter, bylaws, or general corporate policy and coverage under directors' and officers' liability insurance provisions may protect executive officers from personal liability for costs incurred in a successful defense against a claim or lawsuit resulting from the executive officer's service to the issuer. However, in the final rule release, the SEC noted that Section 10D of the Exchange Act provides that the listing standard requirement is that "the issuer will recover," which would be inconsistent with indemnification because a listed issuer does not effectively "recover" the excess compensation from the executive officer if it has an agreement, arrangement, or understanding that it will mitigate some or all of the consequences of the recovery. Therefore, indemnification arrangements that permit executive officers to retain or recover compensation that they were not entitled to receive based on restated financial statements would fundamentally undermine the purpose of Section 10D.

In the final rule release, the SEC further noted that, while an executive officer may be able to purchase a third-party insurance policy to fund potential recovery obligations, the indemnification provision in the SEC Clawback Rule prohibits an issuer from paying or reimbursing the executive officer for premiums for such an insurance policy.

The SEC further noted that any such indemnification or reimbursement would also be prohibited through modification to current compensation arrangements or other means that would amount to *de facto* indemnification, such as, for example, by providing an executive a new cash award which the issuer would then "cancel" to effect recovery of outstanding recoverable amounts.

Disclosure of Clawback Policy

The SEC Clawback Rule provides that the clawback policy must require the issuer to file all disclosures with respect to the clawback policy in accordance with the requirements of the US federal securities laws, including the disclosure required by the applicable SEC filings.

Sanctions for Non-compliance

The SEC Clawback Rule provides that exchanges must prohibit the initial or continued listing of any security of an issuer that is not in compliance with the requirement of any portion of the SEC Clawback Rule.

Therefore, issuers that do not comply with the SEC Clawback Rule and related listing standards will be subject to delisting by the relevant exchange.

NYSE

Failure to Adopt a Clawback Policy

- If an issuer fails to comply with the NYSE Rules (a "**Clawback Requirement Delinquency**"), the issuer is required to notify the NYSE in writing within five days of any type of Clawback Requirement Delinquency.
- When the NYSE determines that a Clawback Requirement Delinquency has occurred, the NYSE will promptly send the issuer a written notification (the "**Clawback Requirement Delinquency Notification**") of the procedures referred to below.
- Within five days after the date of the Clawback Requirement Delinquency Notification, the issuer will be required to:
  - contact the NYSE to discuss the status of the resolution of the Clawback Requirement Delinquency, and
  - issue a press release disclosing the occurrence of the Clawback Requirement Delinquency, a description thereof, the reason for the Clawback Requirement Delinquency and, if known, the anticipated date such Clawback Requirement Delinquency will be cured.
- If the issuer has not issued the required press release within five days of the date of the Clawback Requirement Delinquency Notification, the NYSE will issue a press release stating that the issuer has incurred a Clawback Requirement Delinquency.
- In the 6-month period after the Clawback Requirement Delinquency, the NYSE will monitor the issuer and the status of the Clawback Delinquency Requirement, including through contact with the company, until the Clawback Requirement Delinquency is cured ("**Initial Clawback Requirement Delinquency Cure Period**").

	• If the issuer fails to cure the Clawback Requirement Delinquency within the Initial Clawback Requirement Delinquency Cure Period, the NYSE may, in the NYSE's sole discretion, allow the issuer's securities to be traded for up to an additional six-month period (the "**Additional Clawback Requirement Delinquency Cure Period**") depending on the issuer's specific circumstances. • The NYSE has discretion to determines that an Initial Clawback Requirement Delinquency Cure Period or an Additional Clawback Requirement Delinquency Cure Period is not appropriate, and the NYSE also has discretion to truncate either such cure period. In these circumstances, NYSE suspension and delisting procedures would commence. • The final deadline for the issuer to cure its Clawback Requirement Delinquency before the NYSE cease to trade its listed securities is 12 months after the Clawback Requirement Delinquency Notification. **Failure to Comply with the NYSE Listing Standard** • If the NYSE determines that an issuer is non-compliant with any provision of Section 303A.14 (Erroneously Awarded Compensation) and such issuer does not regain compliance within any compliance period provided by the NYSE, then the NYSE will immediately suspend trading in the listed securities of such issuer and will immediately commence delisting procedures with respect to all such listed securities. The issuer will not be eligible to submit any plan advising the NYSE of definitive action the company has taken, or is taking, that would bring it into conformity with the NYSE continued listing standards.
Nasdaq	• In the "purpose section" preceding Nasdaq Rules, Nasdaq proposes to require that an issuer is subject to delisting if it does not adopt a compensation recovery policy that complies with the applicable listing standard, disclose the policy in accordance with SEC rules or comply with the policy's recovery provisions. • The Nasdaq Rules also require that a noncompliant issuer is required to submit to Nasdaq Staff a plan to regain compliance. • The administrative process for such deficiencies will follow the established pattern used for similar corporate governance deficiencies and would allow Nasdaq Staff to provide the issuer up to 180 days to cure such deficiency. Thereafter, Nasdaq Staff would be required to issue a delisting letter. The issuer could then appeal to the Nasdaq's Hearing Panel, which could allow the issuer up to an additional 180 days to cure the deficiency.

DISCLOSURE REQUIREMENTS

The SEC Clawback Rules require that FPIs must begin providing the disclosures required by the relevant listing standards and the SEC's amended Form 20-F disclosure rules in annual reports filed after the clawback policy is adopted by the FPI.

If an FPI voluntarily elects to provide Item 402 disclosure as a voluntarily domestic filer by using domestic registration and reporting forms, the FPI must provide the disclosure required by Item 402(w) in its annual report or registration statement, as applicable.

Cover Page of Form 20-F

- The following two check boxes are to be added to the cover page of the Form 20-F:

  If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements. ☐

  Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period pursuant to §240 10D-1(b). ☐

- Notwithstanding the above, C&DI 121H.01 (and companion C&DIs in the "Exchange Act Forms" section of the C&DIs) clarifies that, while the new check boxes to the cover page of Form 10-K, Form 20-F and Form 40-F (indicating whether the form includes the correction of an error in previously issued financial statements and a related clawback analysis) became effective on January 27, 2023, companies are not required to provide such disclosure until December 1, 2023 (being the date that listed companies are required to have a clawback policy under the applicable listing standard.

Disclosures Within Form 20-F

Item 6.F of Form 20-F requires an issuer to disclose whether an issuer has been required to recover erroneously awarded compensation pursuant to its clawback policy and to provide disclosure of the issuer's action to recover erroneously awarded compensation. The disclosure requirements are summarized below.

- If, at any time during or after the last completed fiscal year, (i) the issuer was required to prepare an accounting restatement that required recovery of erroneously awarded compensation pursuant to the issuer's clawback policy required by the listing standards adopted pursuant to the SEC Clawback Rule, or (ii) there was an outstanding balance as of the end of the last completed fiscal year of erroneously awarded compensation to be recovered from the application of the policy to a prior restatement, the issuer must provide the following information in its annual report on Form 20-F:
  - For each restatement:
    - the **date** on which the registrant was required to prepare an accounting restatement;
    - the **aggregate dollar amount of erroneously awarded** compensation attributable to such accounting restatement, including an analysis of how the amount was calculated;
    - if the financial reporting measure as defined in the SEC Clawback Rule related to a stock price or TSR metric, the estimates that were used in determining the erroneously awarded compensation attributable to such accounting restatement and an explanation of the methodology used for such estimates;
    - the aggregate dollar amount of erroneously awarded compensation that **remains outstanding** at the end of the last completed fiscal year; and
    - if the aggregate dollar amount of erroneously awarded compensation **has not yet been determined**, disclose this fact, explain the reason(s) and disclose the information required above in the next Form 20-F filed.
  - If recovery would be **impracticable** pursuant to the SEC Clawback Rule, for each current and former named executive officer and for all other current and former executive officers as a group, disclose the amount of recovery forgone and a brief description of the reason the listed registrant decided in each case not to pursue recovery.
  - For each current and former named executive officer from whom, as of the end of the last completed fiscal year, erroneously awarded compensation had been **outstanding for 180 days or longer** since the date the registrant determined the amount the individual owed, disclose the dollar amount of outstanding erroneously awarded compensation due from each such individual. On January 27, 2023, the SEC published a Compliance and Disclosure Interpretation relating to this provision, stating that: "For foreign private issuers that use Form 20-F, individualized disclosure is required about members of their administrative, supervisory, or management bodies for whom the issuer otherwise provides individualized compensation disclosure in the filing."
- If at any time during or after its last completed fiscal year the registrant was required to prepare an accounting restatement, and the registrant concluded that recovery of erroneously awarded compensation **was not required** pursuant to the issuer's clawback policy required by the listing standards adopted pursuant to the SEC Clawback Rule, the issuer is required to briefly explain in its annual report on Form 20-F **why** the application of the clawback policy resulted in this conclusion.

Form 20-F provides that the information disclosed as described above will **not** be deemed to be incorporated by reference into any filing under the Securities Act, except to the extent that the listed registrant specifically incorporates it by reference.

Exhibit to Form 20-F

The amendments made to Form 20-F provide that an issuer that, at any time during its last completed fiscal year, had a class of securities listed on a national securities exchange registered pursuant to Section 6 of the Exchange Act or a national securities association registered pursuant to Section 15A of the Exchange Act, must file as an **exhibit** to its annual report on Form 20-F the clawback policy required by the applicable listing standards adopted pursuant to the SEC Clawback Rule.

This requirement is inserted as paragraph 97 to the Instructions as to Exhibits within Form 20-F (which is consistent with the newly inserted paragraph 97 of Item 601 of Regulation S-K that applies to US domestic registrants). Therefore, the clawback policy should be filed as Exhibit 97 to Form 20-F.

Inline XBRL

The new compensation recovery disclosure in Form 20-F is required to be structured using machine-readable eXtensible Business Reporting Language within the filing ("**Inline XBRL**"). Inline XBRL tagging is required for any specific data points included within the compensation recovery disclosures and block text tagging of compensation recovery disclosures is also required.

Therefore, the use of Inline XBRL will facilitate the extraction and analysis of the disclosed information across a large number of issuers and over several years. Such analysis may include comparison, aggregation and filtering of issuer disclosures.

ENFORCEMENT OF CLAWBACK POLICIES

Timing of Clawback

The SEC Clawback Rule requires the exchange listing standards to require issuers to clawback incentive-based compensation **reasonably promptly**, and this term is not defined. In its final rule release, the SEC noted that, regardless of the means of recovery used, issuers should recover erroneously awarded compensation reasonably promptly, because delays in recovering excess payments allow executive officers to capture the time value of money with respect to funds they did not earn, which should instead belong to shareholders.

Enforcement Mechanisms

The SEC Clawback Rule does not specify or restrict the provisions that can be included within a clawback policy to enable or assist the enforcement of the clawback policy. In its final rule release, the SEC recognized that the appropriate means of recovery may vary by issuer and by type of compensation arrangement and that many different means of recovery may be appropriate in different circumstances. As such, the SEC Clawback Rule permits issuers to exercise discretion in how to accomplish recovery.

The SEC further noted that what is reasonable may depend on the additional cost incident to recovery efforts and that the SEC expects that issuers and their directors and officers, in the exercise of their fiduciary duty to safeguard the assets of the issuer (including the time value of any potentially recoverable compensation), will pursue the most appropriate balance of cost and speed in determining the appropriate means to seek recovery.

In providing discretion to issuers on the means the issuer uses to achieve recovery, the SEC further noted that issuers should act in a manner that effectuates the purpose of the Dodd-Frank Act, which the SEC expressed as being to prevent current or former executive officers from retaining compensation that they received and to which they were not entitled under the issuer's restated financial results.

In its final rule release, the SEC noted the following in connection with an issuer's enforcement of the SEC Clawback Rule:

- The SEC Clawback Rule does not prevent an issuer from securing recovery through **means that are appropriate** based on the **particular facts and circumstances** of each executive officer that owes a recoverable amount.
- An issuer may be acting reasonably promptly in establishing a **deferred payment plan** that allows the executive officer to repay owed erroneous compensation as soon as possible without unreasonable economic hardship to the executive officer, depending on the particular facts and circumstances.
- The SEC Clawback Rule does not prohibit an issuer from establishing compensation practices that account for the **possibility of the need for future recovery**, but the SEC declined to offer specific guidance on which methods may be appropriate, which would depend on the particular facts and circumstances applicable to the issuer.

In its final rule release, the SEC noted that the SEC Clawback Rule does not restrict exchanges from adopting **more prescriptive approaches** to the timing and method of recovery under the listing standards of such exchange, including after an exchange has observed issuer performance and use any resulting data to assess the need for further guidelines to ensure prompt and effective recovery by issuers.

NYSE	• The "purpose section" preceding the NYSE Rules states that in evaluating if an issuer is recovering erroneously awarded incentive-based compensation reasonably promptly, they will consider if the issuer is pursuing an appropriate balance of cost and speed in determining the appropriate means to seek recovery, and if the issuer is securing recovery through means that are appropriate based on the particular facts and circumstances of each executive officer that owes a recoverable amount.

Nasdaq	• Nasdaq Rules also include the same clarification as described above. • In addition, the "purpose section" preceding Nasdaq Rules states that that Nasdaq would determine if the steps an issuer is taking constitute compliance with its compensation recovery policy. The issuer's obligation to recover erroneously awarded incentive-based compensation reasonably promptly will be assessed on a holistic basis with respect to each accounting restatement prepared by the issuer.

Issuers may consider including the following enforcement-related provisions in their clawback policies:

- Require the deferral of incentive compensation to allow for cancellation, forfeiture, or offset.
- Use explicit language that the covered compensation is subject to recoupment (or offset, where permissible) in accordance with the issuer's clawback policy or otherwise required by applicable law.
- Require retention, holdback or lock-up of a significant portion of cash or shares acquired through equity compensation programs to facilitate clawback enforcement.
- Explicitly retain the discretion to withhold future incentive compensation awards and equity awards as a clawback enforcement mechanism.
- Set forth specific terms and establish procedures for recoupment of compensation previously paid.
- Retain the right of offset against amounts otherwise payable (although tax rules for nonqualified deferred compensation and state wage and hour laws may prevent this technique in certain circumstances).

RECOVERY UNDER SECTION 304 OF SOX OR FOREIGN RECOVERY REGIMES

Section 304 of SOX

Section 304 of SOX provides that if an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws, the **chief executive officer** and **chief financial officer** of the issuer shall reimburse the issuer for:

- any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the issuance or filing of the restated financial statements; and
- any profits realized from the sale of securities of the issuer during such 12-month period.

Section 304 of SOX requires misconduct, but the misconduct does not need to be by the chief executive officer or chief financial officer against whom clawback is sought.

The courts have held that only the SEC may order the discouragement of compensation under Section 304 of SOX or bring a cause of action for that purpose, and neither the issuer nor any of its shareholders can sue to enforce Section 304 of SOX. Section 304 of SOX was implemented in 2002 but the SEC initially made limited use the clawback provisions of Section 304 of SOX. The degree to which the SEC has enforced this section over the years has varied. In connection with an enforcement action announced in June 2022, the Director of the SEC's Division of Enforcement noted that the enforcement action should "put public company executives on notice that even when they are not charged with having a role in the misconduct at issue, we will still pursue clawbacks of compensation under SOX 304 to ensure they do not financially benefit from their company's improper accounting."

In its final rule release, the SEC noted that the SEC Clawback Rule is not intended to alter or otherwise affect the interpretation of other recovery provisions, such as Section 304 of SOX, or the determination by the SEC or the courts of when reimbursement is required thereunder. To the extent that the application of the SEC Clawback Rule would provide for recovery of incentive-based compensation that the issuer recovers pursuant to Section 304 of SOX or other recovery obligations, the SEC further noted that it would be appropriate for the amount the executive officer has already reimbursed the issuer to be credited to the required recovery under the issuer's clawback policy pursuant to the SEC Clawback Rule. The SEC continued by noting, however, that recovery under the SEC Clawback Rule would not preclude recovery under Section 304 of SOX to the extent any applicable amounts have not been reimbursed to the issuer.

Therefore, if an issuer is required to prepare an accounting restatement, in addition to applying the SEC Clawback Rule, issuers should also consider any potential clawback consequences under Section 304 of SOX.

Foreign Recovery Regimes

In its final rule release, the SEC also noted that, to the extent that erroneously awarded compensation is recovered under a foreign recovery regime, the recovery would meet the clawback obligations under the SEC Clawback Rule.

IMPLEMENTATION AND OTHER PRACTICAL CONSIDERATIONS

2015 Rule Proposal

The SEC Clawback Rule was first proposed by the SEC on July 1, 2015. Although the final SEC Clawback Rule largely follows the rule as proposed in 2015, issuers should be aware that there are number of notable differences. The most significant difference is the inclusion in the final SEC Clawback Rule of the requirement for issuers to conduct a clawback analysis for "little r" accounting restatements. Therefore, if issuers have put in place clawback policies designed to comply with the SEC Clawback Rule as originally proposed, issuers should update such clawback policies to bring them into compliance with the SEC Clawback Rule.

Existing Clawback Policies and Provisions

FPIs should identify whether they currently have any compensation clawback policies or provisions in place. In addition, FPIs should also identify whether clawback provisions are contained within the terms of any employment agreements, service agreements, compensation plans or compensatory award agreements or documents (such as grants under a long-term incentive plan).

If FPIs have voluntarily adopted compensation clawback policies or provisions, it is possible that such clawback policies may only be triggered if there is misconduct on the part of the executive, may apply to a smaller set of executives, and/or may have a shorter look-back period. These agreements and documents are permitted to continue to include clawback provisions. However, any such agreements and documents would need to be subject to the clawback policy to be adopted by the FPI pursuant to the relevant exchange listing requirements.

SEC Clawback Rule Establish Minimum Requirements

FPIs are permitted to adopt clawback policies that are more extensive than those required by the listing standards of the relevant exchange, so long as such clawback policy satisfies the minimum requirements of the relevant listing standards.

Therefore, when FPIs prepare a clawback policy to comply with the relevant exchange listing requirements, FPIs may also consider whether to adopt more expansive policies – either because their existing clawback policy is broader than the minimum required policy or because the FPI determines additional provisions may be appropriate for its needs.

For example, FPIs may adopt policies that require clawback in additional situations, such as clawback upon employee misconduct or clawback in connection with reputational harm or other non-financial impacts on the FPI. Any additional provisions would be permitted to be exercised at the discretion of the FPI (such as at the discretion of the board of directors or a committee of independent directors). However, care should be taken to ensure that the exercise of discretion is only permitted in connection with requirements that go beyond the minimum requirements of the relevant listing standards and that such discretion does not grant discretion that would be prohibited under such minimum requirements.

Separate Clawback Policies

The SEC Clawback Rule does not limit the number of clawback policies that an issuer may have. Therefore, FPIs may adopt a separate clawback policy to comply with the listing standards of the relevant exchange. An FPI that adopted this approach would put in place a clawback policy that could be limited to the requirement of the SEC's Clawback Rule, and only that policy would be publicly filed on Form 20-F.

Therefore, if an FPI wishes to go beyond the minimum requirements of the SEC's Clawback Rule, but does not wish to make any additional clawback provisions public, the FPI can include such additional clawback provisions in a separate clawback policy that is not required to be filed as an exhibit to Form 20-F.

Clawback on a Pre-Tax Basis

Clawback of incentive-based compensation must be made on a pre-tax basis. This means that if an executive officer received US$ 1 million in erroneously awarded compensation, and paid US$ 500,000 in tax on such erroneously awarded compensation, the executive officer would nonetheless be required to reimburse US$ 1 million to the issuer. In the final rule proposal, the SEC stated that it believed any resulting tax burden should be borne by executive officers, not the issuer and its shareholders.

Whether an executive officer is able to claim a full or partial tax refund or credit in respect of reimbursed erroneously awarded compensation would depend on the income tax, capital gains tax and other tax laws and regulations to which an executive officer is subject. Even if an executive officer is permitted to obtain a tax refund or credit, the timing of any such refund or credit may not align with when an executive officer is required to reimburse the issuer for erroneously awarded compensation.

Furthermore, many multinational companies have executive officers in multiple jurisdictions and an FPI's executive officers may therefore be subject to different tax laws and regulations. Therefore, it is possible that divergent tax laws and regulations could result in unfair or inconsistent tax impacts.

Therefore, FPIs and executive officers should carefully consider the tax implications of the SEC Clawback Rules in each applicable jurisdiction. FPIs and executive officers may evaluate whether any structural modifications to incentive-based compensation may be made in order to mitigate any potential adverse tax consequences of a clawback, such as mandatory deferral of a portion of incentive-based compensation until the end of the clawback period so that if clawback is required it may be able to be applied to a portion of deferred compensation that has yet to be taxed.

Adoption of Clawback Policy and Compensation Committee Matters

An issuer would generally adopt a clawback policy through a resolution of the board of directors. FPIs should confirm the appropriate adoption procedures with legal counsel.

Both the NYSE and Nasdaq allow FPIs to follow home country practice instead of exchange rules related to the compensation committee. However, if an FPI does have a compensation committee (or other committee with a relevant remit), the FPI should check whether the committee charter requires the committee to review the clawback policy prior to adoption by the FPI's board of directors.

In connection with the implementation of the SEC Clawback Rule and relevant listing standards, the board of directors of the FPI may consider whether to amend the compensation committee charter to delegate to the compensation committee the role of (i) developing or reviewing the clawback policy and any amendments to that policy from time to time, (ii) recommending that the board of directors adopt the clawback policy, and (iii) monitoring the implementation of, and disclosures in connection with, the clawback policy (which may include complex questions relating to determination of the amount of erroneously awarded compensation as discussed above). If such amendments are made to the compensation committee charter, FPIs should ensure that the charter is clear that, except in the limited circumstances provided for in the SEC Clawback Rule, issuers do not have any discretion on whether to enforce their clawback policy.

Implementation of Clawback Policy into Operative Documents

In connection with the adoption of a compliant clawback policy, the FPI may also incorporated the policy into the operative documents, including:

- shareholder-approved equity incentive plans and arrangements and corresponding award agreements;
- employment agreements and severance arrangements;
- cash bonus plans or other plans and arrangements; and
- governance policies of the board of directors (or a committee thereof).

The documents may include specific clawback provisions or incorporate an external clawback policy by reference. In any event, the SEC Clawback Rule does not contain an exemption from clawback if clawback is not permitted by the terms of any operative documents.

Issuers should also consider whether to include forward-looking provisions in incentive documentation that provide that the compensation under that agreement is subject to future clawback policies or amendments thereof or applicable law.

Performance-related Conditions to Awards

As described above, compensation is only subject to the SEC Clawback Rule Financial if it was granted, earned, or vested based wholly or in part upon the attainment of a measure that is determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements. Therefore, awards are based on **strategic** or **operational** measures that are not determined in whole or in part based on financial reporting measures are not subject to clawback under the SEC Clawback Rule.

As part of the implementation of the SEC Clawback Rule, issuers should analyze whether or not their performance-related conditions to compensatory awards cause such compensation to be incentive-based for purposes of the SEC Clawback Rule. When considering performance-related conditions generally, an issuer may be prompted to evaluate whether to adopt objective strategic or operational measures rather than financial reporting measures. As part of this process, issuers may seek to engage with compensation consultants.

Keeping Track of Incentive-based Compensation

Depending on the size of the issuer and the number and frequency of grants of incentive-based compensation, it may be complex and time-consuming to keep track of incentive-based compensation that may be subject to clawback. Therefore, issuers should consider computer-based tracking of incentive-based compensation to enable an issuer to determine at any point in time the current and former executive officers whose incentive-based compensation may be subject to clawback. Issuers should also track the contact details of former executive officers so they may be contacted if needed during the clawback period.

Existing Indemnification Provisions

As described above, the SEC Clawback Rule prohibits issuers from indemnifying any current or former executive officer against the loss of erroneously awarded compensation. Therefore, FPIs should consider whether any existing indemnification provisions in favor of current or former executive officers should be amended to address this prohibition. For example, indemnification provisions may be contained in an FPI's articles of association, bylaws or other constitutional documents, as well in any indemnification agreements entered into with directors and officers of the FPI.

FPIs should evaluate with external counsel in relevant jurisdictions whether any such indemnification provisions should be updated to exclude indemnification for loss of compensation that would be prohibited by exchange listing standards that implement the SEC Clawback Rule. For example, FPIs should evaluate with external counsel in relevant jurisdiction whether any provisions that limit the extent of indemnification "to the maximum extent permitted by law" (or similar concepts) maybe sufficient to avoid a failure to comply with the listing standards of the relevant exchange. For instance, if such provision is limited to the law of the jurisdiction of incorporation of the FPI, that may not be sufficiently broad.

In addition, in its final rule release, the SEC noted that they believe that Section 29(a) of the Exchange Act would render any indemnification agreement void and unenforceable to the extent that the agreement purported to relieve the issuer of its obligation under Section 10(D) of the Dodd-Frank Act, the SEC Clawback Rule, and a resulting listing standard to recover erroneously paid incentive-based compensation. The SEC further noted as follows:

> Section 29(a) provides that any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of a self-regulatory organization, shall be void. As courts have noted, by its terms, Section 29(a) prohibits waiver of the substantive obligations imposed by the Exchange Act. The underlying concern of this section is 'whether the [challenged] agreement weakens [the] ability to recover under the Exchange Act.'

However, FPIs should consider with external counsel whether to amend indemnification provisions to expressly limit indemnification that would be impermissible. This may assist in protecting FPIs from claims by current or former executive officers that they are entitled to indemnification for compensation that is clawed back. Alternatively, following discussion with external counsel, FPIs may conclude that it would be appropriate to rely on existing limitations to indemnification provisions, and if an FPI does proceed on that basis, it should consider whether to expressly communicate that position to its current or former executive officers.

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