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NYSE and Nasdaq Allow More Time for Companies to Adopt Rule 10D-1 Clawback Policies: What to Do Now

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This week, both the New York Stock Exchange ("NYSE") and The Nasdaq Stock Market ("Nasdaq", and together with NYSE, the "Exchanges") filed amendments with the Securities and Exchange Commission ("SEC") to provide a delayed effective date for the Exchanges' proposed listing standards requiring listed companies to adopt clawback policies, as mandated by Rule 10D-1 under the Securities and Exchange Act of 1934. Specifically, the Exchanges are proposing that their new listing standards become effective on October 2, 2023. If the listing standards are approved by the SEC, companies will have **until December 1, 2023** (60 days after the effective date) to adopt clawback policies satisfying the new listing standards ("Rule 10D-1 policies"), and the policies would need to apply to any incentive compensation "received" (as defined in Rule 10D-1) on or after October 2, 2023. The NYSE's amended proposal is available here, Nasdaq's is available here, and our client alert on the SEC's adoption of Rule 10D-1 is available here.

The delayed effective dates, which were highly anticipated, align with the SEC's statement when it adopted Rule 10D-1 in October 2022 that it anticipated companies would have "more than a year from the date the final rules are published in the Federal Register to prepare and adopt compliant recovery policies." On June 9, the SEC approved the Exchanges' proposed listing standards, as modified by these amendments to include the October 2, 2023 effective date, on an accelerated basis. The delayed effective dates will ensure that companies have adequate time to draft, customize, and implement Rule 10D-1 policies. When doing so, companies should consider the following issues:

What form should the policy take, and should it be integrated with any existing clawback policy?

The Exchanges' listing standards will require that companies adopt a written policy. Companies that have existing clawback policies need to determine whether to adopt a stand-alone Rule 10D-1 compliant policy, or whether to integrate that policy with their existing clawback policy. When faced with the prospect of an early effective date for the Exchanges' listing standards, some companies were leaning toward adoption of a stand-alone policy, but either approach is acceptable, and with more time to draft and review a compliant policy, we expect both approaches to be common. Factors to consider when making that decision include whether the existing policy applies in contexts other than financial restatements and whether the existing policy covers employees who are not "executive officers" as defined in Rule 10D-1, as well as more nuanced considerations such as how the look-back applies, how recoverable amounts are calculated, and what compensation is covered by the policy. Even if adopting a stand-alone Rule 10D-1 policy, companies should evaluate whether and, if so, how any existing policy will be amended to conform with provisions of the Rule 10D-1 policy, including any transition provisions to apply the existing policy to compensation received prior to the effective date of the Rule 10D-1 policy. Some companies may wish to reconsider the format of their policies, particularly if the current policies are embedded in corporate governance guidelines or other documents, and should consider whether they intend to voluntarily file any other

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clawback policy with the SEC when they are required to file their Rule 10D-1 policy as an exhibit to their annual reports (as discussed below).

Who needs to approve the policy?

Neither of the Exchanges specify what corporate actions need to be taken or by whom to adopt a Rule 10D-1 policy. For many companies, the authority will rest with the Board's compensation committee, either through express language in the committee's charter or through a more general allocation of responsibility to the committee for oversight of executive compensation matters. However, some companies may determine that the matter is better handled by a different board committee or, after a review of applicable committee charter language, may determine that the full Board should approve or ratify approval of the Rule 10D-1 policy. Companies may also wish to consider their historic practice when addressing similar situations, such as when companies adopted hedging policies to address the disclosure requirements of Regulation S-K Item 407(i).

How is the policy enforced?

The Exchanges' listing standards will require that companies not only adopt Rule 10D-1 policies, but also comply with those policies. Companies could face delisting, as well as other possible legal exposure, if they do not recover incentive compensation on a reasonably prompt basis as provided for under their Rule 10D-1 policies. Accordingly, companies need to consider how they will enforce their policies if and when required. We expect that companies will rely on terms in incentive compensation plans, terms in award agreements under those plans, and/or stand-alone undertakings in which executives agree to be bound by and comply with a company's clawback policies. Regardless of the context, greater specificity and explicit written acceptance/signatures by covered executives may enhance enforceability. At the same time, given the breadth of arrangements to which Rule 10D-1 policies could apply (Rule 10D-1 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" as that term is defined in Rule 10D-1), it could be helpful for provisions that will be relied upon to enforce the Rule 10D-1 policy to apply broadly to any compensation arrangement subject to Rule 10D-1. Because the Rule 10D-1 policy needs to apply to any "incentive-based compensation" that is "received" on or after October 2, 2023, with the definition of "received" generally referring to when the applicable financial reporting measure is attained, a Rule 10D-1 policy typically will apply to incentive awards that were granted prior to October 2. Thus, express executive acknowledgements that the Rule 10D-1 policy applies to past grants also may be helpful. Some companies may also seek to document that compensation can be recovered from any amounts that might otherwise be or become due to a current or former executive, including through offsets of amounts due under non-qualified deferred compensation arrangements.

How is the policy implemented?

As noted above, Rule 10D-1 policies will apply broadly to "incentive-based compensation" that is based in whole or in part on a "financial reporting measure," which itself is broadly defined to include measures determined or derived wholly or in part from accounting measures or that are based on stock price or total shareholder return. Under Rule 10D-1 and the Exchanges' listing standards, if a company experiences a restatement that triggers the applicability of the company's Rule 10D-1 policy, the company will be required to document certain determinations and provide such documentation to the applicable Exchange. Companies should therefore carefully survey all compensation arrangements in which executive officers participate to determine which are based on a "financial reporting measure." It will be helpful in administering Rule 10D-1 policies for companies to clearly document the extent to which their executive compensation arrangements do or do not involve a financial reporting measure and, going forward, to clearly document the extent to which financial reporting measures impact the compensation committee's determinations regarding the form or amount of compensation granted, earned, vested, or otherwise

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provided to executive officers.

Does adoption of the policy trigger any disclosure?

Companies will be required to file their Rule 10D-1 policies as an exhibit to their Form 10-K. Compliance with the disclosure requirements is required in the first annual report required to be filed after October 2, 2023, the effective date of the new listing standards, although the SEC stated also that it would not expect compliance with the disclosure requirement until companies are required to have adopted a policy under the applicable Exchange listing standard. Companies should carefully evaluate whether adoption of a Rule 10D-1 policy, or any amendments to existing incentive compensation plans or agreements that implement the policy, constitute material new compensation arrangements or material amendments or modifications that must be disclosed. However, we believe that in most cases those actions will not trigger a Form 8-K filing under Item 5.02(e), due to both the fact that the actions relate to a contingent potential adjustment to amounts payable under existing executive compensation arrangements, and the fact that a Rule 10D-1 policy operates essentially as just an extension of the time over which the evaluation of performance measures is applied. Additional Form 10-K check-box and proxy statement disclosure requirements also apply if a company experiences a restatement during the year, as discussed in our prior client alert, so companies should establish appropriate disclosure controls to allow them to satisfy these disclosure obligations.

The following Gibson Dunn lawyers assisted in the preparation of this alert: Stephen Fackler, Krista Hanvey, Ronald Mueller, Christina Andersen, and Geoff Walter.

Gibson Dunn's lawyers are available to assist with any questions you may have regarding these issues. To learn more about these issues, please contact the Gibson Dunn lawyer with whom you usually work in the firm's Executive Compensation and Employee Benefits or Securities Regulation and Corporate Governance practice groups, or any of the following practice leaders and members:

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