

# PLI – Annual Disclosure Documents

## The Current State of Clawback Requirements and Considerations

December 13, 2016

# Agenda

- Overview of Proposed Rules
- Review of clawback policy considerations
- View from ISS

# Overview of Proposed Rules

- Section 954 of Dodd-Frank
  - Proposed by SEC in July 2015
- Section 956 of Dodd-Frank
  - Proposed by multiple banking agencies and the SEC in April 2016
  - Applies to financial institutions

# Section 954 of Dodd-Frank

## Rule 10D-1 Requirements

1. Disclose presence of a policy on incentive compensation based on financial measures; and
2. If an accounting restatement due to material noncompliance with financial reporting requirements occurs, leads to recovery from current/former executive officers in a three-year look-back period

## Section 954 of Dodd-Frank (cont.)

- Applies to most filers
- Applies to issuers of debt and equity securities
- Only limited types of restatements are exempt
- Date for start of three-year look-back must be calculated
- Applies to more officers than SOX (not just NEOs)
- Complex process for determining the “excess compensation”

## Section 954 of Dodd-Frank (cont.)

- Limited exemptions
  - Impracticable
  - Violate non-U.S. home country law
- No-fault mandate
- Limited discretion of the Board
- Even in pool plans, limited discretion to distinguish between participants

## Section 954 of Dodd-Frank (cont.)

- Disclosure obligations:
  - (1) disclose recovery policy (file);
  - (2) disclose how the recovery policy is applied; and
  - (3) document attempts to recover incentive-based compensation, and why, if applicable, not pursued.
- Specific disclosure about amounts recovered, estimates and calculations, individual officers named and uncollected recovery amounts

# Section 956 of Dodd-Frank

- Section 956 of the Dodd-Frank Act requires six Agencies to jointly prescribe regulations or guidelines with respect to incentive compensation pay practices at certain “covered financial institutions”.

The “Agencies”		
Securities and Exchange Commission	Board of Governors of Federal Reserve	Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation	Federal Housing Finance Agency	National Credit Union Administration

- Goal to prohibit incentive based compensation that encourages inappropriate or could lead to material financial loss.
- General requirements include restrictions on compensation as well as disclosures.



## Rule 956 of Dodd-Frank (cont.)

- Rules first proposed in 2011 (April 12, 2011)
  - Agencies received over 10,000 comments
  - 2016 Proposed rules will replace the 2011 rules, and “reflect the Agencies collective supervisory experience” since 2011
- New Proposed Rules published April 21, 2016
- Comment Period ended July 22, 2016

## Rule 956 of Dodd-Frank (cont.)

- Proposed rules can generally be divided into five categories of rules that work together to regulate compensation practices;
  - What is a “Covered Institution”
    - Three new categories of covered institutions based on total consolidates – Level 1, 2, and 3 “covered institutions”

## Rule 956 of Dodd-Frank (cont.)

- Who is a “Covered Person”
  - New concept of “significant risk-taker” as a type of “covered person”

## Rule 956 of Dodd-Frank (cont.)

- What are compliant “incentive-based compensation arrangements”
  - Distinction between long-term incentive compensation and qualifying incentive based compensation
  - Deferral vs. forfeiture & downward adjustment vs. clawbacks
  - Different individuals subject to different vesting and deferral requirements

# Rule 956 of Dodd-Frank (cont.)

- Risk Management and Control Requirements
  - Independent risk management framework required for incentive based compensation program
- Governance Requirements
  - Compensation committee can only be composed solely of directors who are not senior exec officers required

# Rule 956 of Dodd-Frank (cont.)

- Clawbacks required in incentive compensation plans
  - Incentive-based compensation plans must now include provisions to permit recovery of compensation for at least 7 years post vesting when a current or former senior executive officer or significant risk-taker has engaged in
    - misconduct resulting in significant financial or reputational harm to the covered institution,
    - fraud, or
    - intentional misrepresentation of information.

# Overview of proposed rules

- Impact of Financial Choice Act
  - Rule 954
  - Rule 956
  - Other Dodd-Frank executive compensation provisions

# Tax-Related Issues

- Claim of right doctrine (Section 1341 of Code)
  - May provide relief for taxes paid on recovered income
  - Need to have unrestricted right to receive in year paid
  - Actual responsibility may play a role



# Clawback Policy Considerations

- What are companies doing now?
  - Compensation Committee
  - Stock ownership guidelines
  - Incentive compensation plans and agreements
  - Compensation risk assessment
- Issues for global companies

# Clawback Policy Considerations (cont.)

- Inside counsel view
- Any planned changes for 2017?
- Impact of the election

# Clawback Policy Considerations (cont.)

## View from ISS