

SANGRA MOLLER LLP*Barristers & Solicitors***LEGAL CURRENCY***A Client Communication****U.S. Securities and Exchange Commission Adopts Executive Compensation Clawback Rules***

On October 26, 2022, the U.S. Securities and Exchange Commission (the "SEC") voted to adopt final rules requiring SEC issuers to establish clawback policies for erroneously awarded compensation to current or former executive officers.

Final Rule Amendments

The final rules amend the Securities Exchange Act 1934 to add a new Rule 10D-1 (the "**Rule 10D-1**") directing national securities exchanges and associations to establish listing standards that require a listed issuer to:

- adopt and comply with a written policy for recovery of erroneously awarded incentive-based compensation received by its current or former executive officers in the event it is required to prepare an accounting restatement due to its material noncompliance with any financial reporting requirement under the securities laws, during the three completed fiscal years immediately preceding the date that the issuer is required to prepare an accounting restatement; and
- disclose those compensation recovery policies in accordance with the rules, including providing the information in tagged data format.

The amendments also require all listed issuers to:

- file their written recovery policies as exhibits to their annual reports;
- indicate by check boxes on their annual reports whether the financial statements included in the filings reflect correction of an error to previously issued financial statements and whether any of those error corrections are restatements that required a recovery analysis; and
- disclose any actions they have taken pursuant to such recovery policies.

Executive Officers Subject to the New Rule

The new rule requires recovery of erroneously awarded compensation from "any current or former executive officer of the issuer who received incentive-based compensation" during the three-year look back period. The term executive officer, when used with reference to an issuer, means its president, any vice president of the registrant in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy making function or any other person who performs similar policy making functions for the registrant. Executive officers of

subsidiaries may be deemed executive officers of the issuer if they perform such policy making functions for the issuer.

Incentive-Based Compensation

Rule 10D-1 applies its clawback principles to incentive compensation, which is defined as "any compensation that is granted, earned or vested based wholly or in part upon the attainment of any financial measure". This would include equity and non-equity based compensation. Issuers will be required to recover incentive compensation paid to current and former executives equal to the excess of the payment over the amount that would have been paid in the absence of an error in the issuer's financial statement. Salaries, bonuses paid at the discretion of the board or the compensation committee that are not paid from the bonus pool, and equity awards which are not contingent upon achieving financial reporting measures are examples of compensation that is not considered incentive-based as per the SEC final rules.

Restatements

The clawback of erroneously paid incentive compensation is triggered under Rule 10D-1, where the issuer is required to make an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under applicable securities laws, including those:

- correcting a material error in previously issued financial statements (referred to as "Big r" restatements); or
- correcting an immaterial error to previously issued financial statements, but that would lead to a material misstatement if the error was left uncorrected in the current report or the error correction was recognized in the current period (referred to as "Little r" restatements).

Limited Discretion

Rule 10D-1 requires recovery regardless of "fault" or responsibility for the error or resulting restatement and that the issuer should pursue recovery in most instances.

An issuer may choose not to pursue a claim to recover erroneously awarded compensation to the extent that it would be impracticable. Impracticability exceptions are available only in the circumstances where:

- direct expenses paid to third parties to assist in enforcing the policy would exceed the amount to be

recovered, and the issuer has made a reasonable attempt to recover;

- in the case of a foreign private issuer, recovery would violate the home country law that existed at the time of adoption of the rule, and the issuer provides an opinion of counsel to that effect to the exchange; or
- recovery would likely cause an otherwise tax-qualified retirement plan to fail to meet the requirements of the Internal Revenue Code.

Indemnification and Insurance

The new rule prohibits issuers from insuring or indemnifying any executive officer or former executive officer against the loss of erroneously awarded compensation. Boards may not allow covered executives to repay clawed back amounts in installments.

Foreign Private Issuers

Canadian issuers listed on U.S. stock exchanges and other foreign private issuers will be subject to the new rules.

Effective Dates

The final rules are effective 60 days following publication in the federal register. Each stock exchange compliant will be required to file proposed listing standards no later than 90 days following its publication in the federal register. Issuers subject to such listing standards will be required to adopt a policy no later than 60 days following the date on which the applicable listing standards become effective and must begin to comply with these disclosure requirements in proxy and information statements and the issuer's annual report filed on or after the issuer adopts its policy.

This communication is intended to provide general information as a service to our clients and should not be construed as legal advice or opinions on specific facts.