

Navigating the Application of a Clawback Policy to Restatements and Recovery Periods Before October 2, 2023

FEBRUARY 29, 2024

As discussed in prior blog posts,^[1] on June 9, 2023, the Securities and Exchange Commission (the **SEC**) approved listing standards promulgated by the New York Stock Exchange (**NYSE**) and Nasdaq Stock Market (**Nasdaq**) regarding the recovery of erroneously awarded incentive-based compensation,^[2] referred to as “clawbacks.” These rules were mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Specifically, new Section 303A.14 of the NYSE Listed Company Manual and new Nasdaq Rule 5608 implement the requirements of Rule 10D-1 adopted by the SEC in November 2022 (the **Final Rules**). Listed companies were required to adopt clawback policies that comply with the Final Rules by December 1, 2023, with an effective date as of October 2, 2023 (a **Clawback Policy**).

As discussed more fully below, the determination of whether compensation is subject to clawback under the Final Rules can be complex, depending on items such as: (1) the date that a restatement of issuer financials is determined to be required, (2) the accounting periods that are restated, and (3) the date that compensation was received.

OVERVIEW OF FINAL RULES

Under the Final Rules, following an accounting restatement, the issuer must reasonably promptly claw back erroneously awarded incentive-based compensation received by an executive officer during the “Recovery Period.” The “**Recovery Period**” is defined as the issuer’s three completed fiscal years immediately preceding the date it is determined that the issuer is required to prepare an accounting restatement.

For purposes of determining the relevant Recovery Period, the date that an issuer is determined to be required to prepare an accounting restatement (the **Restatement Determination Date**) is the earlier of:

- i. the date an issuer’s Board of Directors or Board committee (or 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; or
- ii. the date a court, regulator, or other legally authorized body directs the issuer to prepare an accounting restatement.

The date an issuer actually files the restated financial statements does not affect the determination of the Recovery Period.

Incentive-based compensation is *deemed* received in the fiscal year in which the compensation's financial reporting measure goal is attained. Accordingly, the date of grant, payment, or issuance of the incentive-based compensation may not be the same fiscal year in which such compensation is deemed received for purposes of the Final Rules.

However, the Final Rules do not apply to incentive-based compensation that is received before the Final Rules' October 2, 2023 effective date.

WHEN DOES A RESTATEMENT FOR A FISCAL YEAR THAT ENDED BEFORE OCTOBER 2, 2023 TRIGGER A CLAWBACK?

The answer depends on the Restatement Determination Date.

For issuers with calendar year fiscal years, if the Restatement Determination Date occurred on or before December 31, 2023, then the Recovery Period runs from January 1, 2020 through December 31, 2022, *i.e.*, the three completed fiscal years *immediately preceding* December 31, 2023. Since any incentive-based compensation received *before* the Final Rules' October 2, 2023 effective date is *not* subject to clawback thereunder, any restatement with a Restatement Determination Date on or before December 31, 2023 will not result in a clawback under the Final Rules. This is because, for calendar-year issuers, the three-year lookback period for the Recovery Period would consist of fiscal years that all ended prior to October 2, 2023, resulting in no incentive-based compensation being received *during* the Recovery Period *and* on or after October 2, 2023. Therefore, no incentive-based compensation is subject to such issuer's Clawback Policy. See Example 1 below.

There are different results for a calendar year issuer if the Restatement Determination Date occurs after December 31, 2023, as illustrated in Example 2 below.

In addition, the results may differ if the issuer is not a calendar year filer depending on the Restatement Determination Date. See Example 3 below for an example of an issuer with a June 30 fiscal year end that had a Restatement Determination Date after October 2, 2023, but that results in no incentive-based compensation subject to such issuer's Clawback Policy since the Recovery Period would consist of fiscal years that all ended prior to October 2, 2023.

Example 1

A calendar-year issuer determined in February 2023 that a restatement was required relating to its 2022 financials. The issuer had also granted (i) an annual cash bonus in 2022 earnable based on a financial reporting measure that was impacted by the restatement and (ii) Performance Share awards with a 2021–2023 performance period earnable based on a financial reporting measure that was impacted by the restatement. The cash bonuses are deemed received on December 31 of each year to which they relate (*i.e.*, FY22 bonus is received on December 31, 2022) and the 2021–2023 Performance Share award is deemed received as of December 31, 2023.

Restated Financials:	FY2022, 12/31/22
Restatement Determination Date:	February 15, 2023
Recovery Period:	January 1, 2020 – December 31, 2022

Date Compensation Deemed Received:	Cash Bonus <ul style="list-style-type: none"> • FY22 Bonus, December 31, 2022 2021–2023 Performance Share <ul style="list-style-type: none"> • December 31, 2023
Is the incentive-based compensation received <i>after</i> October 2, 2023?	<ul style="list-style-type: none"> • No, for the Cash Bonus • Yes, for the Performance Shares
Is the incentive-based compensation received during the Recovery Period?	<ul style="list-style-type: none"> • Yes, for the Cash Bonus • No, for the Performance Shares
Is the incentive-based compensation subject to clawback under the Final Rules?	No for both. To be subject to clawback, incentive-based compensation must be received <i>after</i> October 2, 2023 <i>and</i> during the Recovery Period.

Example 2

Same facts as Example 1, except the Restatement Determination Date is one year later, on February 15, 2024.

Restated Financials:	FY2022, 12/31/22
Restatement Determination Date:	February 15, 2024
Recovery Period:	January 1, 2021 – December 31, 2023
Date Compensation Deemed Received:	Cash Bonus <ul style="list-style-type: none"> • FY22 Bonus, December 31, 2022 2021–2023 Performance Share <ul style="list-style-type: none"> • December 31, 2023

<p>Is the incentive-based compensation received after October 2, 2023?</p>	<ul style="list-style-type: none"> • No, for the Cash Bonus • Yes, for the Performance Shares
<p>Is the incentive-based compensation received during the Recovery Period?</p>	<ul style="list-style-type: none"> • Yes, for the Cash Bonus • Yes, for the Performance Shares
<p>Is the incentive-based compensation subject to clawback under the Final Rules?</p>	<p>No, for the Cash Bonus, because it was not received after October 2, 2023.</p> <p>Yes, for the Performance Shares, since they are received <i>after</i> October 2, 2023 <i>and</i> during the Recovery Period.</p>

Example 3

Same facts as Example 2, except the issuer’s fiscal year runs from July 1 to June 30.

<p>Restated Financials:</p>	<p>FY2022, 6/30/22</p>
<p>Restatement Determination Date:</p>	<p>February 15, 2024</p>
<p>Recovery Period:</p>	<p>July 1, 2020 – June 30, 2023</p>
<p>Date Compensation Deemed Received:</p>	<p>Cash Bonus</p> <ul style="list-style-type: none"> • FY22 Bonus, June 30, 2022 <p>2021-2023 Performance Share</p> <ul style="list-style-type: none"> • June 30, 2023
<p>Is the incentive-based compensation received after October 2, 2023?</p>	<ul style="list-style-type: none"> • No, for the Cash Bonus • No, for the Performance Shares

Is the incentive-based compensation received during the Recovery Period?

- Yes, for the Cash Bonus
- Yes, for the Performance Shares

Is the incentive-based compensation subject to clawback under the Final Rules?

No for both. To be subject to clawback, incentive-based compensation must be received *after* October 2, 2023 *and* during the Recovery Period.

WHAT SHOULD AN ISSUER DO IF IT HAD A RESTATEMENT DETERMINATION DATE AND RELATED RECOVERY PERIOD BEFORE OCTOBER 2, 2023?

If an issuer has had a recent restatement, as contemplated under the issuer's Clawback Policy, the Compensation Committee of the issuer's Board of Directors^[3] should evaluate the impact of the restatement on incentive-based compensation received by the issuer's current and former executive officers.

If the Restatement Determination Date or the entire Recovery Period for a restatement occur *prior to* October 2, 2023 – as demonstrated in Example 1 above – we generally recommend that the Compensation Committee analyze the impact of the restatement and adopt resolutions reflecting the Compensation Committee's determination that all incentive-based compensation in the Recovery Period was received before October 2, 2023, and therefore no recovery of erroneously awarded incentive-based compensation is required under the Clawback Policy. This establishes a clear record that the Compensation Committee evaluated the application of the policy as it applies to incentive-based compensation in light of the recent restatement. Of course, the Compensation Committee may wish to consider if any prior clawback or recoupment policies previously maintained by the issuer may necessitate a clawback even if not specifically required under the new mandated Clawback Policy.

WHAT SHOULD AN ISSUER DO IF IT HAD A RESTATEMENT DETERMINATION DATE AFTER OCTOBER 2, WHERE (1) THE RESTATEMENT RELATES TO A FISCAL YEAR BEFORE OCTOBER 2, 2023, 2023 AND (2) PART OF THE RELATED RECOVERY PERIOD IS AFTER OCTOBER 2, 2023?

If the Restatement Determination Date and part of the Recovery Period for a restatement occur *after* October 2, 2023, but the restatement relates to a fiscal year *before* October 2, 2023 – as demonstrated in Example 2 above – the Compensation Committee should analyze the impact of the restatement pursuant to the Clawback Policy. This is true even where the restated financials are corrected before the incentive compensation is paid.

For example, a calendar year issuer granted Performance Shares with a 2021–2023 performance period that are deemed received as of December 31, 2023. In February 2024, the Board of Directors determined that a restatement of the 2022 financials was required. If the required restatement of the 2022 financials is completed in March 2024 in connection with the 2023 Form 10-K and the Compensation Committee's determination of the performance results for 2023, the Compensation Committee should evaluate whether the performance goal had been attained by using the restated financials for the portion of performance relating to fiscal year 2022. Since that award is received after October 2, 2023, it is subject to clawback under the issuer's Clawback Policy. However, it should not result in erroneously awarded compensation due to a restated financial performance measure since the Compensation Committee evaluated the performance goal using the restated financials. We recommend establishing a clear record of the Compensation Committee analyzing the impact of the restatement and adopting resolutions reflecting the Compensation Committee's determination that no erroneously awarded compensation was received by any executive officer. Depending on the timing, this evaluation could be completed as part of certifying the performance results for such incentive-based compensation award.

[1] See [Key Implementation Steps for Listed Companies as Deadline for Adopting Clawback Policies Rapidly Approaches](#) and [SEC Adopts Final Compensation Clawback Rules; Companies Should Begin Preparing for New Requirements](#).

[2] “Incentive-based compensation” is generally any compensation that is granted, earned, or vested based wholly or in part upon the attainment of a financial reporting measure.

[3] Under the Final Rules, independent directors of the issuer responsible for executive compensation decisions, or in their absence, a majority of the independent directors of the issuer, are responsible for administering the issuer’s Clawback Policy. For purposes of this blog post, we assume that the Compensation Committee of an issuer will be both approving compensation for executive officers and administering the Clawback Policy. If an issuer has different groups of independent directors serving in these roles, or is otherwise not required to have independent directors approve executive officer compensation (e.g., a foreign private issuer, certain controlled companies), the recommendations in this blog post would still apply, but the recommended actions may need to be taken by both the entity or individuals in charge of approving executive compensation and the administrator of the issuer’s Clawback Policy.

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