

## CLAWBACK POLICIES: BEYOND COMPLIANCE

*Already prevalent among large companies, robust clawback provisions can be part of a holistic approach to holding executives accountable.*

**FOR LARGE PUBLIC COMPANIES**, the December 1, 2023 deadline for meeting the SEC’s final clawback rules was something of a non-event from a corporate governance perspective. In the lead-up to the mandate taking effect, many voluntarily adopted provisions that materially met or, in some cases, even exceeded the financial restatement clawback policy required by the Dodd-Frank Act. In fact, in a recent survey by FW Cook, 80 percent of large-cap companies reported having clawback provisions that extend beyond those laid out by the SEC.

Prescriptive and narrow, the SEC’s clawback rules call for companies to maintain policies to recover excess incentive payouts from current and former executive officers in the event of financial restatements. The expanded compensation clawback policies adopted by large companies generally include provisions covering a broader group of employees, applying to more than just incentive-based pay and/or extending to situations other than financial restatement, explains Erin Bass-Goldberg, a managing director at FW Cook, who sees the prevalence of robust clawback policies as a sign of growing recognition of the importance of internal accounting/governance controls combined with compensation accountability features that extend beyond Dodd-Frank clawback policies.

“We’re in an environment where there is greater sensitivity from a governance perspective to ensuring that boards have the necessary tools to hold executives accountable,” she says. “The view is, ‘If we have an individual or a group of people who are taking actions that are not aligned with what they are supposed to be doing—bad actors—we need to have policies in place to hold them accountable for the adverse impact that their actions may have on the company.’”

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SEC’s requirements are a good start, they can fall short of offering the recourse companies may need—and that shareholders and proxy advisory firms now look for from companies. “Many large institutional investors, such as BlackRock, have publicly stated that they prefer more expansive clawback policies,” says Matt Lum, a principal at FW Cook, who adds that ideally, clawback provisions should be viewed in the context of being one component of a comprehensive corporate accountability policy. “What we’re seeing now is a movement beyond compliance to governance best practices so that boards have appropriate compensation accountability tools in their toolbox.”

### COMPLIANCE IN CONTEXT

Compensation committees can start that process by inventorying the various provisions of a compensation program to understand how they work together and identify any gaps that expanded clawback policies might fill. For example, discretion to reduce incentive payouts may be incorporated in the company’s annual and long-term incentive program and/or cause forfeiture of incentive awards in the event of termination of employment.

“That discussion gives companies the opportunity to take a holistic approach to compensation accountability policies by looking at the pillars under that header—award agreements, termination provisions, severance policy, clawback policy—to make sure they aren’t caught off guard,” suggests Lum. “These events are rare, but if one occurs, you don’t want to be in the situation of saying, ‘I wish we had a more robust policy.’”

“It’s important that all companies, regardless of size, make sure they’re comfortable that the policies in place support that accountability,” agrees Bass-Goldberg, who adds that gaps surfaced during the review can then inform clawback policy considerations. “With which executives and in what situations would we want to have the ability to take action? And do we have the tools available to do that?”

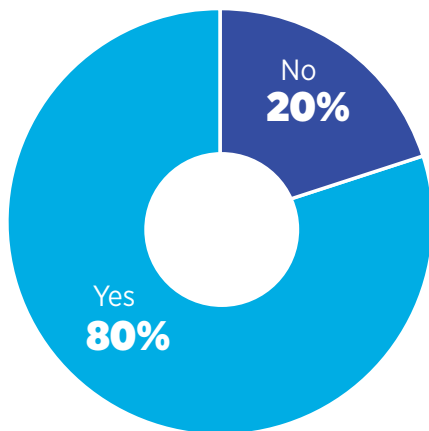
Often, the discussion will identify potential actions that might inflict reputational harm to the company without necessarily requiring a financial restatement, such as violation of a company’s code of conduct that has a significant negative impact on shareholder value. Companies may also stress-test their current practices by running historic or hypothetical situations through their compensation program to evaluate whether it provides for appropriate accountability measures.

“Simulation-testing of policies—looking at ‘What would we have done?’ and ‘How would these have worked?’—can be helpful,” Lum says, adding that as with most aspects of executive compensation, there is no one-size-fits-all approach to adopting an expanded clawback policy or other provisions. “These situations are messy and will require a lot of critical thinking on the part of the board to properly hold the relevant participants accountable.”

Among the 80 percent of large-cap companies surveyed that reported hav-

## Expanded Clawback Policy Prevalence

80% of large-cap companies participating in a recent FW Cook survey report maintaining clawback policies that go beyond SEC requirements.



Source: FW Cook

ing broader clawback policies in place, common features included:

**Coverage of Broader Population:** Sixty-six percent reported having clawback provisions that cover a broader population than SEC requirements, either by title (i.e. vice president/senior vice president and above), coverage of all corporate officers or the entire executive leadership team. (See chart, above right).

**Broader Compensation:** While the SEC's clawback requirements only mandate coverage of incentive-based compensation, 67 percent of companies with broader clawback provisions included discretionary cash and/or time-based equity awards in addition to incentive pay.

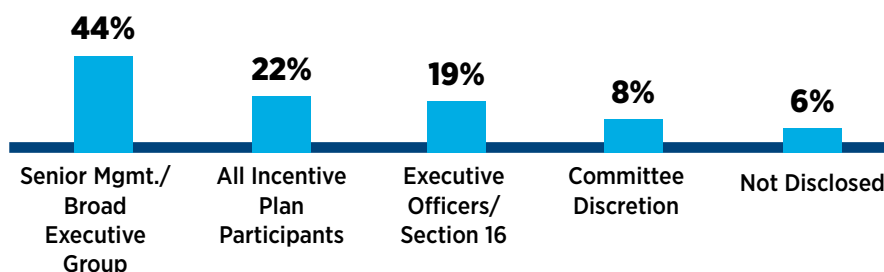
**Broader Triggers:** Many companies extended the events that could trigger their ability to recoup compensation beyond financial restatement to include actions such as fraud or misconduct (64 percent), reputational, financial or other harm (31 percent), violation of company policy/code of conduct (25 percent) or violation of restrictive covenants.

When considering which provisions

## Covered Executives

66% of surveyed companies report having clawback policies that cover a broader population than required by the SEC.

### Does the Expanded Clawback Policy Apply to... Broader Population (n=36)



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to include in an expanded clawback policy, boards should look at options in the context of how they fit with other methods of holding employees accountable, says Bass-Goldberg. “It’s hard to envision all the potential scenarios where you might want to be able to claw back compensation, which is why it’s important that the board have discretion to address accountability in various ways, whether it’s through the annual incentive plan, clawback policy or severance policy,” she says.

Being mindful of the need for flexibil-

ity and the importance of regularly reviewing provisions to ensure they continue to align with the business strategy and evolving best practices in governance is also key. “This is not a set-it-and-forget-it process,” notes Lum. “Revisiting clawback provisions should be part of an annual review of compensation risk. Companies should also continue to monitor market practices, as well as investor and proxy firm expectations.”



*Erin Bass-Goldberg, a managing director at FW Cook, advises companies on executive compensation strategy, design of incentive programs and transaction-related executive compensation issues.*



*Matt Lum, a principal at FW Cook, has extensive expertise in compensation plan structure, aligning incentive plans with long-term strategy and comparing pay and performance.*