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Proposed Rule 10D-1: Listing Standards to Recover Erroneously Awarded Executive Compensation

On July 1, 2015, the U.S. Securities and Exchange Commission (SEC) proposed a new rule to implement section 954 of the *Dodd–Frank Wall Street Reform and Consumer Protection Act*. The comment period for proposed Rule 10D-1 of the *Securities Exchange Act of 1934*, as amended (Exchange Act), ended in September 2015; however, to date a final rule has not been released. Under proposed Rule 10D-1, U.S. national securities exchanges must adopt listing rules that will require all listed issuers, including Canadian companies and other foreign private issuers, to adopt, publicly disclose and implement written policies to recover from the issuer's current and former executive officers any incentive-based compensation received that was based on materially erroneous financial information.¹

The recovery policy would apply to all incentive-based compensation received by executive officers during the three completed fiscal years immediately preceding the date on which the issuer is required to prepare an accounting restatement to correct an error that is material to its previously issued financial statements.² The issuer's obligation to prepare the restatement will trigger the application of the recovery policy. Recovery of the excess compensation will be on a pre-tax, no-fault basis and the issuer cannot indemnify or reimburse the affected officers.

"Incentive-based compensation" is defined in the proposed rule as any compensation that is granted, earned or vested wholly or in part upon the attainment of any financial reporting measure. Financial reporting measures are measures that are determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements, any measures derived wholly or in part from such financial information, and stock price and total shareholder return, regardless of whether such measures are included in an SEC filing or the

¹ Rule 10D-1, as proposed, will apply to all issuers with any securities listed on a U.S. national securities exchange, including issuers with only debt securities listed.

² The term "executive officer" is defined to include the issuer's president, principal financial officer, principal accounting officer (or if there is no such accounting officer, the controller), any vice-president of the issuer 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 issuer. Executive officers of the issuer's parent or subsidiaries are deemed executive officers of the issuer if they perform such policy-making functions for the issuer. The proposed rule would require recovery of excess incentive-based compensation received by an individual who served as an executive officer of the listed issuer at any time during the performance period for that incentive-based compensation. Incentive-based compensation would be subject to the issuer's recovery policy under the proposed rule to the extent that it is received while the issuer has a class of securities listed on an exchange or an association.

issuer's financial statements. In the case of compensation based on stock price or shareholder return, the issuer must calculate the recovery amount by making a reasonable estimate of the accounting restatement's effect on the applicable measure. The recovery policy would not apply to compensation awarded strictly on the basis of discretionary, subjective, operational or strategic measures that are not financial reporting measures.

Exceptions

The SEC proposed only two exceptions to the mandatory enforcement of the recovery policy. First, listed issuers can decide not to recover excess incentive-based compensation if recovery is impractical because the direct cost of recovery is greater than the recovery amount.³ Second, foreign private issuers do not have to enforce their recovery policy if it would violate the laws of their home country.⁴ Any listed issuer making use of either exception must provide detailed supporting documentation to its listing exchange.

Disclosure Requirements

Rule 10D-1, as proposed, will impose various disclosure obligations on a listed issuer, including the requirement to file its written recovery policy as an exhibit to its Form 10-K (or, in the case of a foreign private issuer, Form 20-F or Form 40-F, as applicable). Each listed issuer will be required to disclose annually how it has applied its recovery policy if at any time during its last completed fiscal year it completed either a restatement that required recovery of excess incentive-based compensation under its recovery policy or there was an outstanding balance of excess incentive-based compensation from the application of that policy to a prior restatement. The required disclosure would include the date of the accounting restatement, the recovered amount and the applicable incentive measure. A listed issuer that decides not to recover excess incentive-based compensation because recovery would be impractical must disclose the name of the applicable officer, the amount that would have been recovered and the issuer's reasons for not recovering such amount.

Domestic listed issuers would include the proposed disclosure in their annual reports on Form 10-K and any proxy and consent solicitation materials that require executive compensation disclosure under Item 402 of Regulation S-K. Foreign private issuers, including Canadian issuers using the multijurisdictional disclosure system, would be required to provide the same disclosure in, and to file their recovery policies as an exhibit to, the annual reports they file with the SEC on Form 20-F or Form 40-F, as applicable. Because foreign private issuers are exempt from section 14(a) of the Exchange Act, they would not be required to disclose the information in any proxy or consent solicitation materials with respect to their securities.

³ To prevent potential conflicts of interest, any determination that recovery would be impractical would need to be made by the issuer's committee of independent directors that is responsible for executive compensation decisions. In the absence of a compensation committee, the determination would need to be made by a majority of the independent directors serving on the issuer's board of directors. Such a determination, as with all determinations under proposed Rule 10D-1, would be subject to review by the listing exchange.

⁴ The relevant home country law must have been adopted in the home country prior to the publication in the Federal Register of proposed Rule 10D-1. Interestingly, there is no corresponding exception for a recovery that would violate the laws of the executive officer's home country.

If you have any questions regarding the foregoing, please contact [Jeffrey Nadler](#) (212.588.5505) or [Jennifer Liu](#) (212.588.5543) in our New York office.

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