

Clawbacks: How Do They Work?

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Quick Poll

- **Raise your hand if:**
 - ✓ Your bank has a clawback policy
 - ✓ Your bank is considering implementing a clawback policy

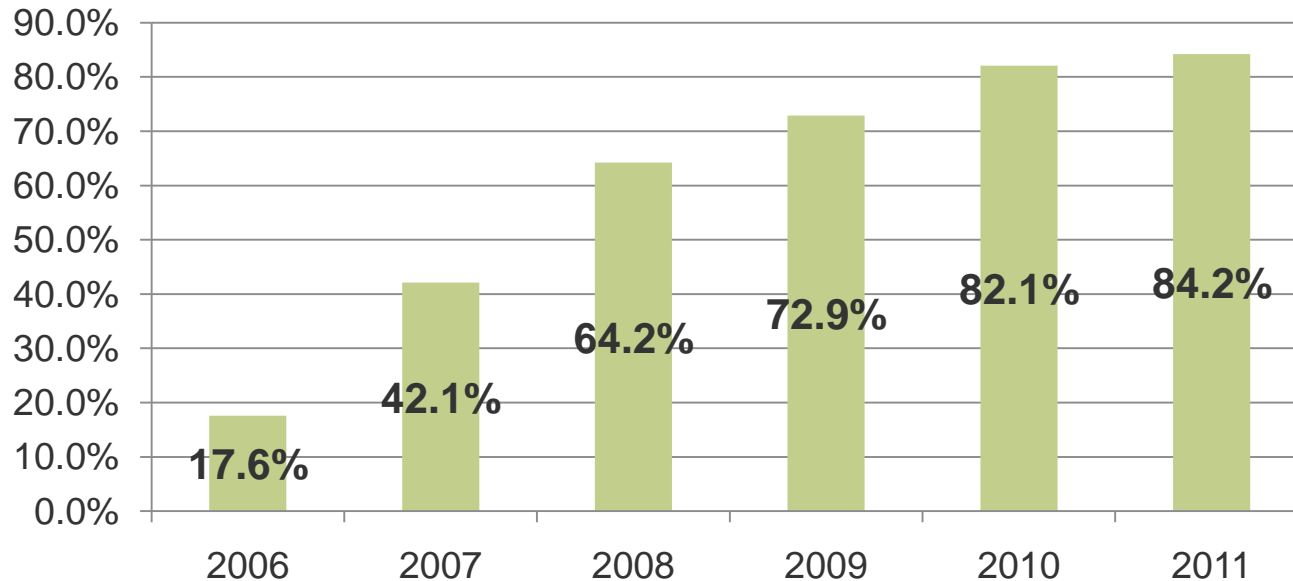
Reason for Clawbacks

- **Provide disincentive against fraud and/or ethical misconduct**
- **Discourage actions that could potentially harm the financial position of a company**
- **Reinforce commitment to pay-performance alignment**
- **Be part of an overall compensation philosophy that embraces sound risk management**
- **Seen as best practice**
- **Soon to be required for all public companies**

Overview

- Even in advance of Dodd –Frank implementation, clawbacks have emerged as a relatively new best practice, particularly among large companies (although not to the level of DFA)
- Nearly 80% of clawback policies were developed in 2009 – 2011.

Prevalence of Fortune 100 Companies with Publicly Disclosed Clawback Policies



■ Current Requirements for Clawbacks

■ Sarbanes – Oxley

- Only CEO and CFO
- Recoupment of incentive payments (cash and equity) for accounting restatements as a result of misconduct
- Payments received during the 12-month period following the release or filing of the erroneous accounting statement

■ TARP

- Recoupment of incentive payments made to CEOs and the next 20 highest paid executives
- Must have knowingly provided inaccurate information related to the financial statements or performance metrics used to calculate their own incentive pay

Unlike requirements to date, Dodd-Frank does not require executive misconduct.

■ Requirements – Dodd-Frank Act (DFA)

- All public companies to implement and disclose a policy for incentive pay recoupment in the event of a material financial restatement
- Must recover from any current or former executive officer who received, based on erroneous data, incentive-based compensation (including stock options awarded as compensation)
 - During the three-year period preceding the date on which the company is required to prepare an accounting restatement
 - In excess of what would have been paid to the executive officer under the accounting restatement

Implementation Update: SEC to propose regulations by December 2011; final regulations to be issued first half 2012

▪ Many Open Issues

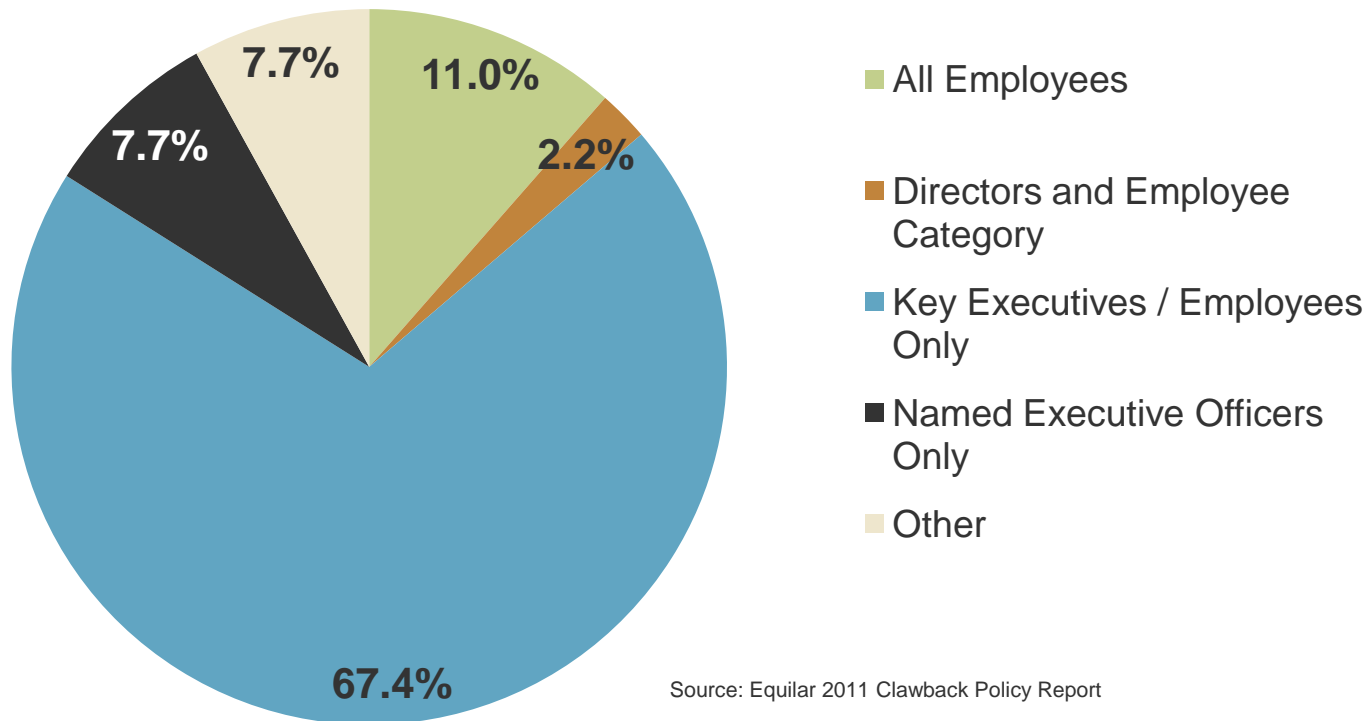
- Further guidance from the SEC is required, including, but not limited to:
 - How will clawbacks be applied to compensation delivered to an individual who becomes an executive officer after grant but before restatement?
 - How will the amount to recoup be calculated where not subject to specific financial measures?
 - How will the three year look back period apply to options granted, vested and/or exercised during the previous three year period and what would be the recoupment value when applicable?
 - What does “received” mean? Is a stock option “received” on grant? Vesting? Exercise? Sale of shares received upon exercise? How is it valued?
 - If the exercise price of an option is higher than it would have been, is that an offset against the clawback?
 - If a bonus was discretionary, does the Committee consider how it would have exercised its discretion taking into account the restatement? Or does the clawback only cover objectively-determined incentive-based compensation based on quantifiable financial information?

■ Elements of a Clawback Policy

- **Who should be covered?**
- **What is the triggering event(s)?**
- **What type(s) of compensation should be subject to recovery?**
- **What is the time period during which recovery can be sought?**
- **How will the policy be enforced?**
- **What discretion will the board have in administering the policy**
- **How will the policy be communicated?**

Who Should be Covered?

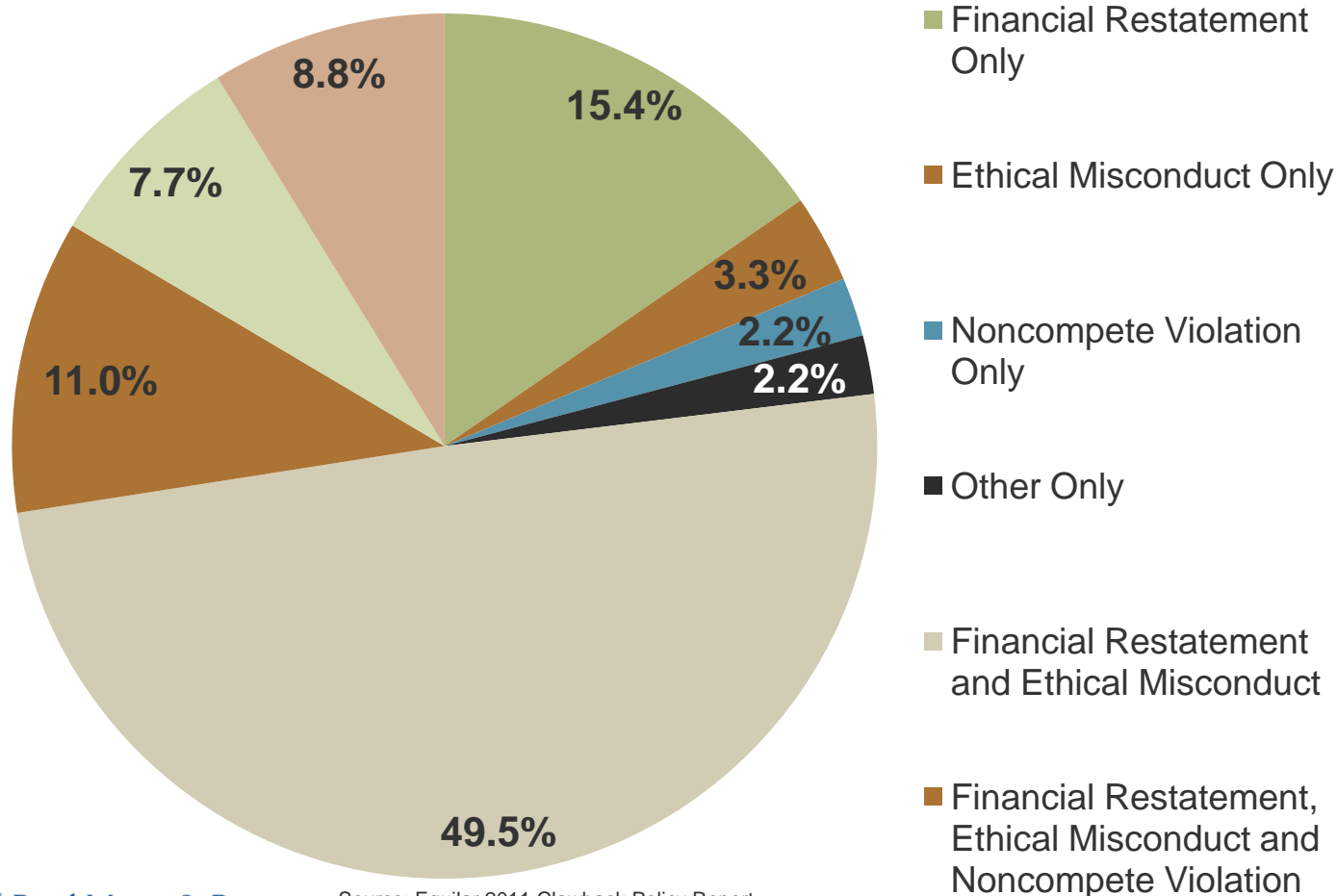
Clawback Policy Employee Coverage at Fortune 100 Companies in 2011



DFA includes current and former “executive officers” (using Section 16 definition); SOX only covered CEO and CFO

What Should be the Triggering Event?

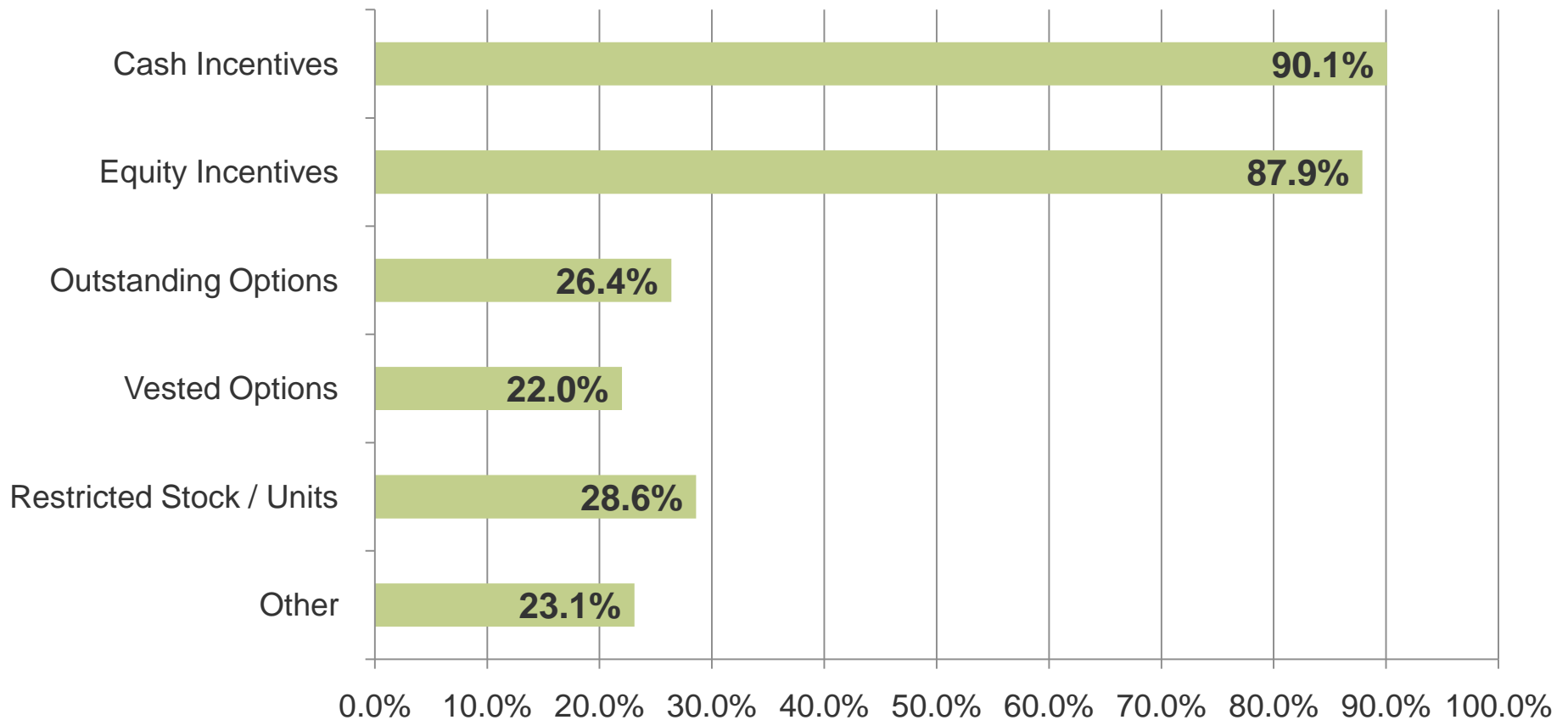
Prevalence of Clawback Triggers Among Fortune 100 Policies Disclosed in 2011



DFA's trigger is material financial restatement

What Type of Compensation is Covered?

Prevalence of Fortune 100 Clawback Policies Covering Key Elements of Compensation in 2011



Source: Equilar 2011 Clawback Policy Report

Written Policy – EXAMPLE framework

Clawback Element	DFA Language	Suggested Design	Comments
Who is covered?	Current or former “executive officers”	“Executive Officers” to include NEOs and Section 16 officers	Section 16 officers are generally included in this definition; the bank may want to consider extending to a broader group
What is the triggering event?	Company is required to prepare an accounting restatement due to material noncompliance with financial reporting under securities rules	Track DFA language	Track DFA language until further guidance is provided. Unlike SOX, DFA applies regardless of executive misconduct
What is the recovery period?	Three-year period preceding the date the company is required to prepare restatement	Limit to awards received with respect to 2012 performance period paid within 3-year period prior to restatement	DFA language is vague; until further guidance is provided, limit recovery period to awards paying out for 2012. Revisit policy for 2013 or when final rules are issued.
What types of overpayments are covered?	Incentive-based compensation (including stock options) paid during previous three years	Apply to plans but only to the extent based on financial measures and to extent impacted by restatement	This DFA provision raises the most ambiguities; recommend a narrow approach with Board discretion until further guidance is provided
Who enforces the policy?	No guidance	The full Board of Directors, based upon recommendation of the Compensation Committee	Full Board should have discretion to determine if and how much may be recouped
How will it be communicated?	No guidance	Formal communication sent to those covered by clawback provision (prospective only); may also require amendment to plans and agreements with participant consent	Executive Officers should be aware that the clawback could have a significant impact on awards in 2012

Written Policy Examples

Examples Policies will be Shared During Session

■ Enforcement & Unintended Consequences

- Recent attempts at enforcement by the SEC
 - CEO CSK Auto Corporation and CEO Beazer Homes USA, Inc. (despite no executive wrongdoing)
- Potential lawsuits by shareholders and activists likely
- Enforcement will likely to be difficult and ramifications for unsuccessful attempts are not known
- Potential unintended consequences:
 - Reduced focus on incentive/performance pay?
 - Greater focus on base pay?
 - Less focus on financial metrics in incentive plans?

Proactive and Preventative Strategies

- Consider plan design features that may reduce the risk of seeking recoupment or provide means of recapturing pay in the event of a restatement:
 - Long-term compensation aligned with time horizon of risk
 - Ownership guidelines/holding requirements
 - “Banking” a portion of incentive payments; rolling bonuses
 - Deferred compensation arrangements
 - Hold until/through retirement policies



Questions, Discussion and Debate?