

**MEMO# 34334**

November 1, 2022

# SEC Adopts Clawback Rule and Related Amendments

[34334]

November 1, 2022

TO: ICI Members

Investment Company Directors SUBJECTS: Audit and Attest

Audit Committees

Closed-End Funds

Compensation/Remuneration

Compliance

Disclosure

Exchange-Traded Funds (ETFs)

Fund Accounting & Financial Reporting

Fund Governance

Unit Investment Trusts (UITs) RE: SEC Adopts Clawback Rule and Related Amendments

Last week, the SEC adopted a new incentive-based compensation "clawback" rule (the "rule") and related amendments by a 3-2 vote.[\[1\]](#) The final rule could require certain listed registered management investment companies ("funds") to adopt clawback policies as required by their exchanges and comply with new SEC disclosure requirements, depending on the funds' compensation practices. This summary focuses on the potential impacts to funds.

## Background

Section 954 of the Dodd-Frank Act added Section 10D to the Securities Exchange Act of 1934 (the "Exchange Act"). Section 10D requires the SEC to adopt rules directing the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that does not develop and implement a policy providing for:

- disclosure of the issuer's policy on incentive-based compensation that is based on financial information reported under the securities laws; and
- recovery of incentive-based compensation that the issuer's executive officers receive during the preceding three-year period in excess of what they would have received under an accounting restatement.

The policy purpose is to prevent executive officers from retaining incentive-based compensation that they were awarded erroneously.

The SEC initially proposed the rule and related amendments to implement these requirements in 2015 and re-opened the comment period in 2021. ICI responded to both requests for comment,[\[2\]](#) in each case recommending that all registered funds be excluded from any final rule.

## Summary of the Final Rule

### Applicability of the Rule

Final Rule 10D-1 under the Exchange Act exempts security futures products, standardized options, and securities of UITs and registered management investment companies "if such management company has not awarded incentive-based compensation to any executive officer of the company in any of the last three fiscal years, or in the case of a company that has been listed for less than three fiscal years, since the listing of the company." Registered funds are mostly carved out from the rule because the SEC recognized that "the compensation structures of issuers of these securities render application of the rules unnecessary."[\[3\]](#)

Therefore, the rule and applicable form amendments will apply only to those registered funds[\[4\]](#) that:

- list their securities on an exchange (i.e., ETFs and closed-end funds);
- have at least some degree of internal management (i.e., have paid employees of their own, as opposed to relying on an investment adviser's employees, whom the adviser alone pays); and
- pay their executive officers incentive-based compensation.

As noted above, ICI's advocacy focused on obtaining a complete exclusion from the rule for registered funds. Otherwise, we noted, internally managed exchange-listed funds and certain other listed funds that provide incentive-based compensation to their chief compliance officers (CCOs) could be subject to the rule. The SEC did not take this recommendation. Moreover, the SEC did not categorically exempt fund CCOs from the definition of "executive officer."[\[5\]](#)

### Additional Terms of the Rule

The rule will require each national securities exchange and national securities association, to the extent that each lists securities, to:

- prohibit the initial or continued listing of any security of an issuer that is not in compliance with the rule's requirements;
- no later than 90 days after the release's date of publication in the Federal Register, propose rules that comply with the rule (such rules must be effective no later than one year after the release's date of publication in the Federal Register); and
- Require that each listed issuer adopt the required recovery policy no later than 60 days following the effective date of the listing standard, comply with that recovery policy, and provide the required disclosures in the applicable SEC filings.

The rule will require a listed issuer to adopt and comply with a written policy providing for the recovery of erroneously awarded incentive-based compensation[\[6\]](#) to executive officers[\[7\]](#) "in the event that the issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws, including any required accounting restatement to correct an error

in previously issued financial statements that is material to the previously issued financial statements, or that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period."[\[8\]](#)

The rule contains detailed provisions about: when (generally, a three-year look-back period) and to whom (executive officers) the recovery policy must apply; determining the relevant recovery period; calculating the amount of erroneously awarded compensation (including based on stock price or total shareholder return); the issuer's recovery obligations (including "impracticability" exceptions); and what constitutes "receipt" of incentive-based compensation. The rule prohibits an issuer from indemnifying executive officers against the loss of erroneously awarded compensation. The policy will apply to all executive officers irrespective of fault.

## **Form Amendments Applicable to Funds**

The rule will subject applicable funds to new disclosure requirements. Amended Form N-CSR will require these funds to provide annual disclosure about accounting restatements that required recovery of excess incentive-based compensation[\[9\]](#) and file as exhibits their recovery policies. Amended Schedule 14A will require similar disclosure about accounting restatements and recoveries in proxy statements and information statements relating to the election of directors.[\[10\]](#)

## **Next Steps**

The rule and amendments are effective 60 days after the date the release is published in the Federal Register. Next:

- each exchange will be required to file its proposed listing standards no later than 90 days following the date of the release's publication in the Federal Register;
- the listing standards must be effective no later than one year following the date of the release's publication in the Federal Register; and
- each issuer subject to such listing standards will be required to adopt a recovery policy no later than 60 days following the date on which the applicable listing standards become effective.

The release states that the SEC would not expect compliance with the disclosure requirements until issuers are required to have a policy under the applicable exchange listing standard.

Matthew Thornton  
Associate General Counsel

Jason Nagler  
Senior Director, Fund Accounting & Compliance

## **Notes**

[\[1\]](#) Listing Standards for Recovery of Erroneously Awarded Compensation, SEC Release Nos. 33-11126; 34-96159; IC-34732 (Oct. 26, 2022) (the "release"), available at [www.sec.gov/rules/final/2022/33-11126.pdf](http://www.sec.gov/rules/final/2022/33-11126.pdf). Chair Gensler and Commissioners Crenshaw and Lizárraga voted in favor of the rule and amendments, and Commissioners Peirce and

Uyeda voted against them.

[2] The ICI comment letters are available [here](#) and [here](#).

[3] Release at n.25 and accompanying text. See also id. at n.66: "Listed funds, unlike most other issuers, are generally externally managed and often have few, if any, employees that are compensated by the fund (i.e., the issuer). Instead, listed funds typically rely on employees of the investment adviser to manage fund assets and carry out other related business activities. Such employees are typically compensated by the investment adviser of the registered management investment company as opposed to the fund."

[4] BDCs are not categorically excluded because they are a type of closed-end management investment company that is not registered under the Investment Company Act.

[5] Release at n.68.

[6] The rule defines "financial reporting measures" as "measures that are determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements, and any measures that are derived wholly or in part from such measures. Stock price and total shareholder return are also financial reporting measures. A financial reporting measure need not be presented within the financial statements or included in a filing with the Commission." The release provides as examples of financial reporting measures for funds and BDCs net assets or net asset value per share.

[7] The rule defines "executive officer" in part as "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."

[8] This represents an expansion from the proposal, which focused on restatements for errors that are material to the previously issued financial statements. Also, the release notes, "When we refer to financial statements for registered investment companies and business development companies, we mean the statement of assets and liabilities (balance sheet) or statement of net assets, statement of operations, statement of changes in net assets, statement of cash flows, schedules required by 17 CFR 210. 6-10, financial highlights, and accompanying footnotes, as required by Commission regulations." Release at n.75.

[9] Specifically, a fund would disclose, for each accounting restatement that required recovery of erroneously awarded compensation, or for which there was an outstanding balance of erroneously awarded compensation to be recovered: the date on which the fund was required to prepare an accounting restatement; the aggregate dollar amount of erroneously awarded incentive-based compensation attributable to such accounting restatement (including an analysis of how the amount was calculated); the estimates that were used in determining the erroneously awarded incentive-based compensation, if the financial reporting measure related to a stock price or total shareholder return metric; the aggregate dollar amount of erroneously awarded incentive-based compensation outstanding; and, if the aggregate dollar amount of erroneously awarded compensation has not yet been determined, this fact and the reason(s) why. If a fund decided not to pursue recovery, it must describe its reason and disclose the name of the executive officer and

amount forgone. A fund also would disclose, if applicable, the name of each individual from whom erroneously awarded incentive-based compensation had been outstanding for 180 days or longer, along with the outstanding amount owed. This information would be tagged using Inline XBRL.

[\[10\]](#) Item 22(b)(20) of Schedule 14A cross-references Item 18 of Form N-CSR.

---

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.