

# ***Executive Compensation:*** ***Clawbacks***

## 2013 Proxy Disclosure Study

April 2014  
Human Resource Services

## **Clients and friends:**

PwC is pleased to share with you our *Executive Compensation: Clawbacks—2013 Proxy Disclosure Study*. This study presents our analysis of 2009 through 2012 year-end proxy disclosures for 100 large public companies relative to their compensation recoupment or “clawback” policies. While many 2013 proxies have been filed at this point, we hope this study will help inform 2014 compensation strategies.

Clawback policies, although not new, have been receiving more attention in recent years. Clawback policies have been the focus of discussions in the news, in the courts, and in compensation committee and annual shareholder meetings. With the passage of the Sarbanes-Oxley Act of 2002 (“SOX”), CEO’s and CFO’s have been “on the hook” to return awards after a financial restatement if earned as a result of misconduct. More recently, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”) directed the SEC to craft new rules for additional clawbacks. As a result, many companies modified their clawback policies in anticipation of the new rules, which have yet to be issued.

Clawbacks are a way for employers to incentivize certain behaviors and hold employees accountable for their actions. They have also been adopted to address the increased scrutiny on executive compensation policies by investors, regulators and the media. The number of companies that disclose clawbacks has seen a significant increase in the years following the 2008 financial crisis.

Of note - although the policies are in place, it remains relatively uncommon to see them in action. There have only been a few high profile cases in recent years. It is not clear whether this is due to a lack of enforcement or a lack of misconduct.

In preparing the study, we looked to proxy filings of Fortune 100 and other large and established companies for 2009 through 2012. As 24 of the companies selected did not disclose clawback provisions, we selected 24 additional companies. In certain cases we used additional information available in other filings or on the company’s website to clarify their policy.

After reviewing each disclosed policy, we noted the various events that potentially trigger a clawback of compensation, as well as the type of compensation it relates to (cash or equity or both), the look-back period, repayment approach, and whether it applies to vested or unvested awards, or both. We compared the current clawback policies to previous years and identified those companies who have made changes to their provisions, and the nature of those changes.

We hope you find this study useful and we look forward to working with you as your compensation programs continue to evolve. Please don’t hesitate to reach out to your local PwC team or one of the authors if you would like to continue the conversation.

Best Regards,

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## Introduction

When providing employees with bonuses, stock options, or other incentive awards, companies often establish provisions that allow them to recoup all or a portion of the award under certain circumstances. These provisions are referred to as clawbacks or otherwise described as compensation repayment or recoupment policies and are detailed by most public companies in their annual proxy statement.

Clawbacks are nothing new. Companies often adopt clawback provisions voluntarily to encourage or deter certain actions or behaviors. These provisions may also be included to comply with various laws and regulations. The Sarbanes-Oxley Act of 2002 requires public companies to claw back CEO and CFO awards earned in the one-year period prior to a financial restatement as a result of misconduct. More stringent requirements for companies receiving assistance under the Troubled Asset Relief Program of 2008 (“TARP”) expanded the clawback requirements to the top twenty highly paid executives and eliminated the need to prove misconduct by the executive. Dodd-Frank hoped to significantly expand repayment provisions by requiring clawbacks from executive officers (current or former) of any erroneously awarded compensation in the three-year period prior to a restatement, without consideration of misconduct.

The SEC was charged with the task of writing the clawback rule mandated by Dodd-Frank, and initially announced an expected rulemaking timeframe of mid-2011. Though many expect a proposed rule sometime in 2014, the revised timing remains unclear. Without final rulemaking, questions abound:

- Will clawback be required if financial results were in error, but a restatement was not required?
- Will the clawback apply if the incentive compensation was not based on financial results at all (such as a non-financial operational performance metric)?
- Will the clawback policy apply to both cash and share-based compensation?
- Who will be considered an “executive” for purposes of this clawback provision?
- Does the three-year period start when the error was made, the date it was discovered, the date the restated financial statements were filed or something different?

Notwithstanding the lack of final rules on the Dodd-Frank clawbacks, we have seen many companies developing new types of clawbacks over the last few years. Some in the financial services industry have responded to requests by banking regulators to implement more stringent recoupment provisions in cases where executives were found to have taken excessive risk. Other industries have also started developing new provisions focused on employee risk-taking and accountability for operational performance.

Overall the companies sampled featured a wide range of clawback triggers in their clawback policies, but the most common reason companies seek to clawback is when there is a restatement, either with or without employee involvement, or misconduct. Restatement and misconduct remain the most common clawback triggers in each of the industries studied. This is not surprising given the Sarbanes-Oxley Act requirements and pending Dodd-Frank-related regulations. However, as further described in this study, we saw many other triggers for clawbacks in our sampled companies.

### **Accounting considerations**

Many companies have modified their clawback policies since enactment of Sarbanes-Oxley and Dodd-Frank, and others have indicated that their clawback policies will likely change once the SEC issues its clawback rules. As companies consider adding or changing clawback policies, they need to consider potential accounting implications.

*Companies often adopt clawback provisions voluntarily to encourage or deter certain actions or behaviors. These provisions may also be included to comply with various laws and regulations.*

Under the existing accounting rules, a “traditional” clawback feature does not impact the equity award’s value and expense pattern. If the clawback were ever invoked, accounting recognition would only be needed at that time to reflect the recoupment of the cash or shares<sup>1</sup>.

As companies look to develop new types of clawbacks to address a variety of risks, some may wish to add performance metrics that affect vesting or retention of the award (e.g., an employee is required to return outstanding awards if there is a loss on their trading desk or in their division). Depending on how they are structured, these performance requirements may not be considered clawbacks at all, but instead represent performance conditions of the award. In that case, the accounting implications could be significant.

Another consideration is whether the clawback includes flexibility and/or discretion, such as determining when/if a clawback has been triggered and the amount to be recouped. In some cases, this discretion may result in an assessment that the key terms and conditions of the arrangement are not established and understood, and as a result, the award may need to be marked-to-market<sup>2</sup>. This is a complex area and significant judgment is often required.

*Please note: This study was not intended to assess the accounting treatments applied by any of the companies in our study.*

<sup>1</sup> FASB Accounting Standards Codification 718-10-30-23 through 30-24 and 718-20-35-2.

<sup>2</sup> For more on the accounting treatment for clawbacks, readers may refer to PwC's HRS Insight 10/36 *Accounting for Clawbacks in Stock Compensation Arrangements, Including the Dodd-Frank Act's Provision on Recovery of Erroneously Awarded Compensation*.

## Industry representation

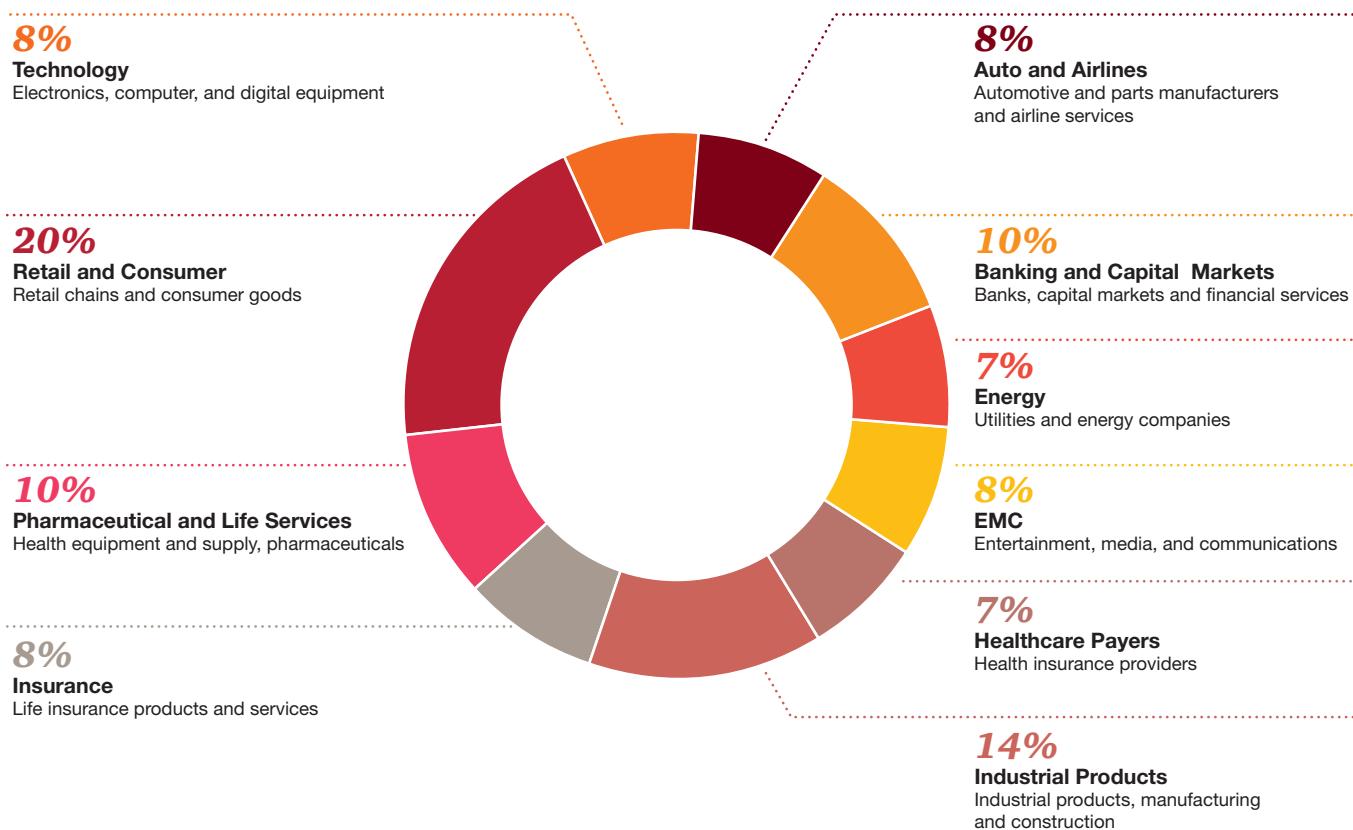
Our 2013 study evaluated the various features of clawback policies along with other related data for 100 large US public companies. We performed our analysis of the disclosures made by these companies based on published annual reports and other publicly available information.

Data has been compiled for 100 companies that disclosed clawback policies by industry sector. Below is a description of these groupings and the percentage each industry sector represents of the total.

# 100

*Data has been compiled for 100 companies that disclosed clawback policies by industry sector.*

### Sector representation



## Clawback triggers

Of the companies in our study, 92% have policies to recoup compensation if there's a **restatement** of financial results. However, of those 92%, 73% require evidence that the employee caused or contributed to false or incorrect financial reporting, while 27% require repayment in the event of a restatement without personal accountability. In many cases, the clawback is only triggered for a material restatement or the amount of the clawback is only the excess of the amount paid over the corrected payments after applying the restatement.

Below is an example of a clawback provision that considers the employee's involvement with a restatement:

*"Pursuant to this policy, in the event our Board or an appropriate committee thereof determines that any fraud, negligence or intentional misconduct by an executive officer was a significant contributing factor to the Company having to restate all or a portion of its financial statements, the Board or committee will take, in its discretion, such action as it deems necessary to remedy the misconduct and prevent its recurrence. Such actions may include requiring reimbursement of bonuses or incentive compensation paid to the officer ..."*

Another prevalent reason for recoupment of incentives was misconduct (84%), which includes breaking a company's code of conduct or ethics policies, being convicted of a criminal offense, or other transgressions and often overlaps with the above at times of a restatement.

Below is an example of a clawback provision with misconduct as a trigger, separate from a restatement clawback trigger:

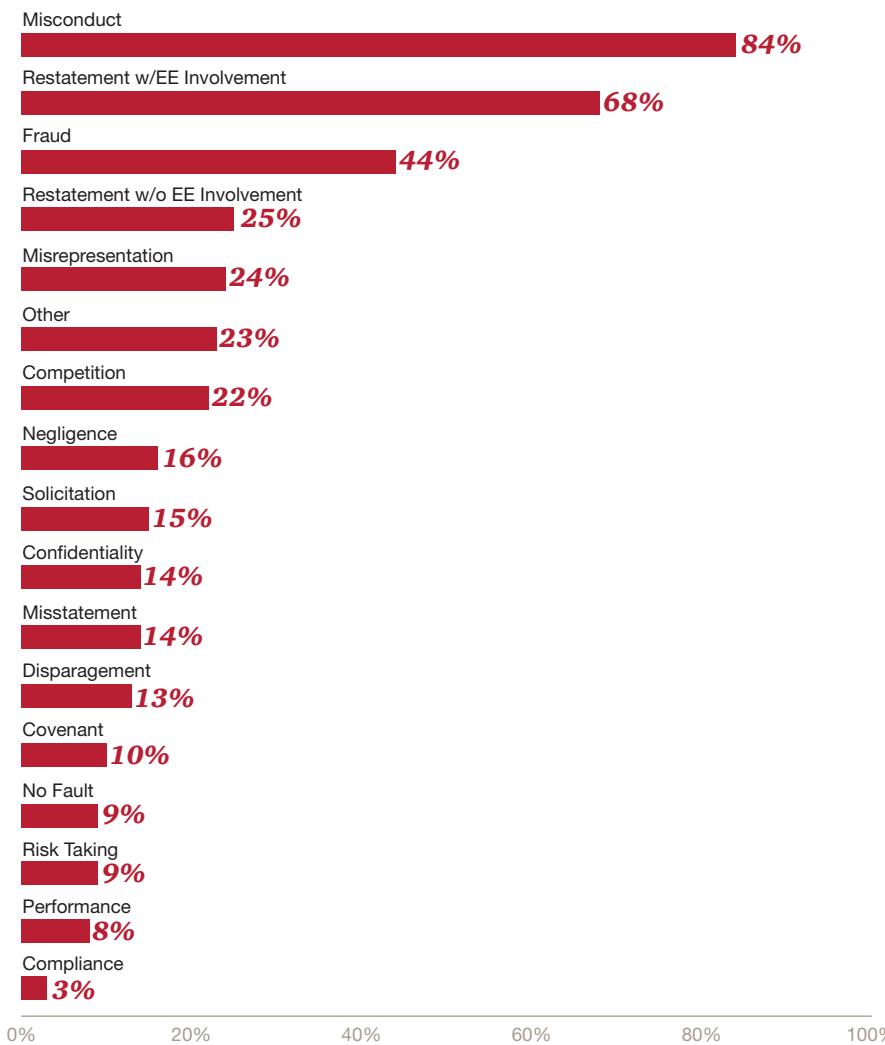
*"The named executive officers' RSU awards are granted under the Company's standard form of RSU agreement. This agreement requires an employee to deliver or otherwise repay to the Company any shares or other amount that may be paid in respect of an RSU award in the event the employee commits a felony, engages in a breach of confidentiality, commits an act of theft, embezzlement or fraud, or materially breaches any agreement with the Company."*

Less widespread for the 100 companies, but worth noting, were clawbacks for committing **fraud** (44%), **competition**: breaking non-compete agreements (22%), **misrepresentation** of performance results to purposely attain higher incentive payments (24%), **negligence** or general lack of supervision/oversight of subordinates (16%), violating **non-solicitation** agreements during or just after the employment period (15%), **misstatement** of financial or performance results without any intentions (14%), breaking a **covenant** other than non-solicit, non-compete, etc. (10%), financials impacted but through **no fault** of the employee (9%), **performance** targets/thresholds not met by the company or division (8%), or company standards for **compliance** (continuing education, certifications, credential criteria) are not met (3%).

The bar graph below reflects the percentage of companies that disclosed a particular clawback trigger (many companies disclosed more than one trigger). As one might expect, industry results generally followed overall results, but there were a few variances. The sectors indicating clawbacks for restatements with employee involvement ranged from 38% of the Insurance companies included in our study, to 100% of the Healthcare Payers sector studied.

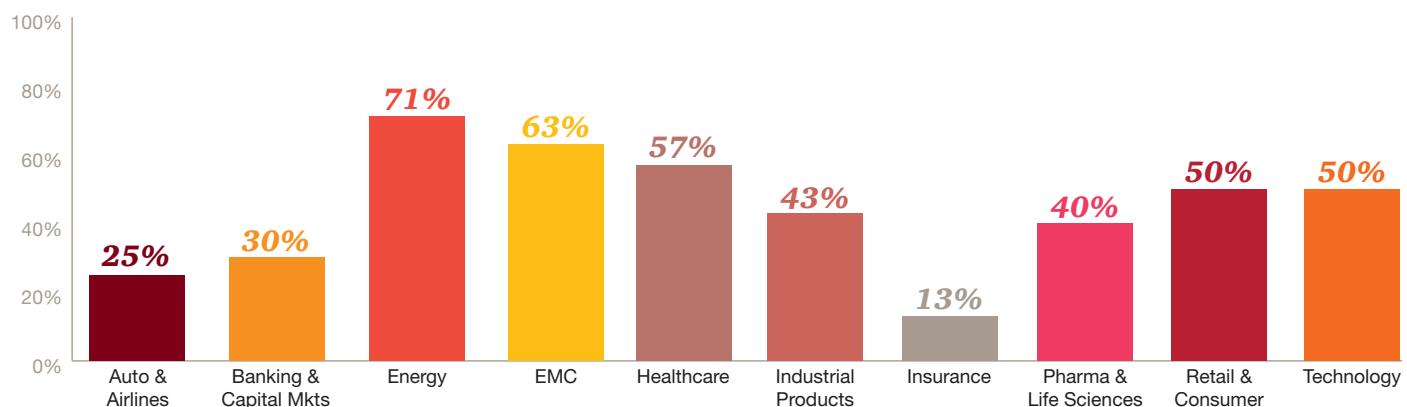
When we include restatement for any reason, five of the study sectors (Auto and Airlines, Banking and Capital Markets, Energy, Healthcare Payers, and Pharmaceuticals and Life Sciences) hit the 100% mark (meaning all of the studied companies in that sector included a restatement trigger of some kind). We noted that in addition to restatement with employee involvement and fraud, Insurance showed a lower percentage in other common triggers such as misconduct, misrepresentation and competition.

#### Clawback trigger prevalence



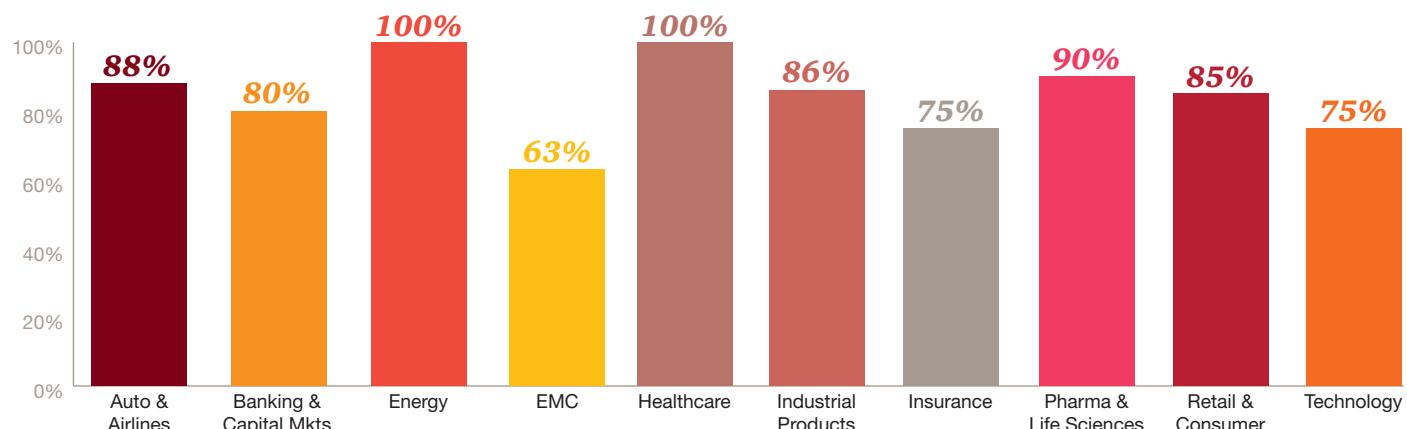
Below are the sector comparisons for several of the common clawback triggers beyond restatements such as fraud and misconduct. While about half the companies selected included a fraud component in their clawback policies, there was a wide range among individual sectors, from 13% in the Insurance sector to 71% in the Energy sector.

#### Companies with a fraud trigger



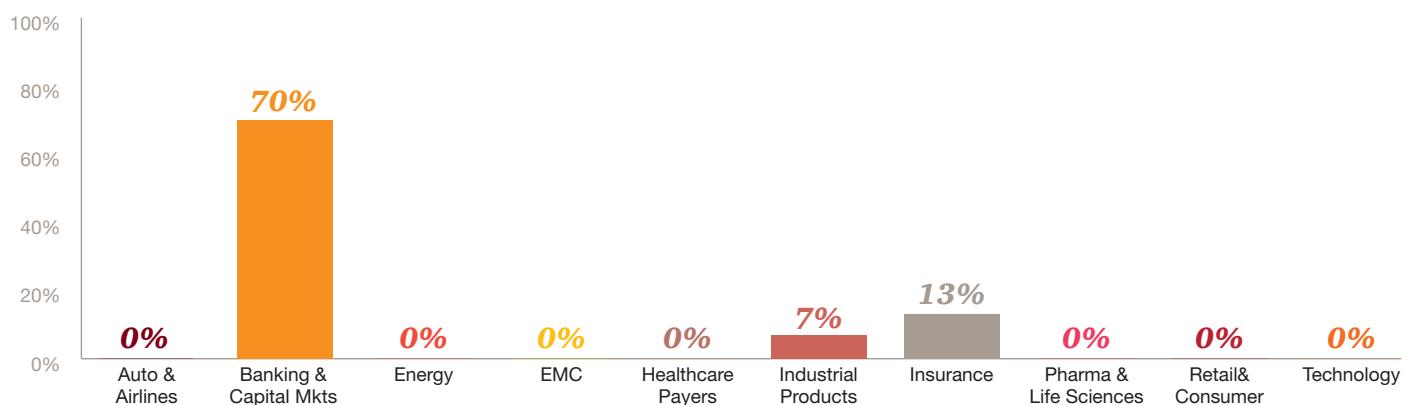
All of companies in the Healthcare Payer and Energy sector indicated misconduct as a clawback trigger; however, it was only mentioned by 63% of EMC sector companies.

#### Companies with a misconduct trigger



New types of recoupment policies have been developed by companies in recent years; the most common addresses inappropriate risk-taking by executives. Financial services firms have led the way in developing these clawbacks, which generally permit recovery of compensation when an employee is found to have violated formal company risk policies or quantitative risk scorecards.

#### **Companies with an excessive risk trigger**



Some recent examples of clawback policies from financial services firms focused on excessive risk-taking:

*“In addition, by adding the risk-related action clawback, [the Bank] is able to recoup unvested equity awards from senior leaders whose inappropriate risk-taking activities have resulted in or are expected to result in a material adverse impact to [the Bank] in the future. By doing so, [the Bank] is able to add further risk-balancing to our incentive arrangements by accounting for both forward- and backward-looking risk adjustments. These changes were made effective for incentive compensation awards made on or after January 1, 2013.”*

*“In addition, the...Committee adopted a global incentive compensation discretion policy that sets forth standards for the exercise of managerial discretion in annual performance compensation decisions and specifically provides that all managers must consider whether an employee effectively managed and supervised the risk control practices of his or her employee reports during the performance year.”*

Other unique recoupment provisions recently adopted include:

*“To supplement compliance and escalation processes, the Company’s independent control functions (the Internal Audit, Legal, Risk and Finance departments) take part in an enhanced, robust review process for identifying*

*and evaluating situations occurring throughout the course of the year that could require clawback or cancellation of previously awarded compensation, as well as adjustments to current-year compensation.”*

*“The equity awards for our NEOs are subject to clawback provisions. In the case of termination for cause the awards will be rescinded.”*

*“For these... awards, and other equity awards granted to our named executives beginning in 2013, added an adjustment provision that gives the HRC full discretion to cancel all or a portion of these awards if...the award was based on materially inaccurate performance metrics, whether or not the executive was responsible for the inaccuracy, or...”*

## Discretionary features

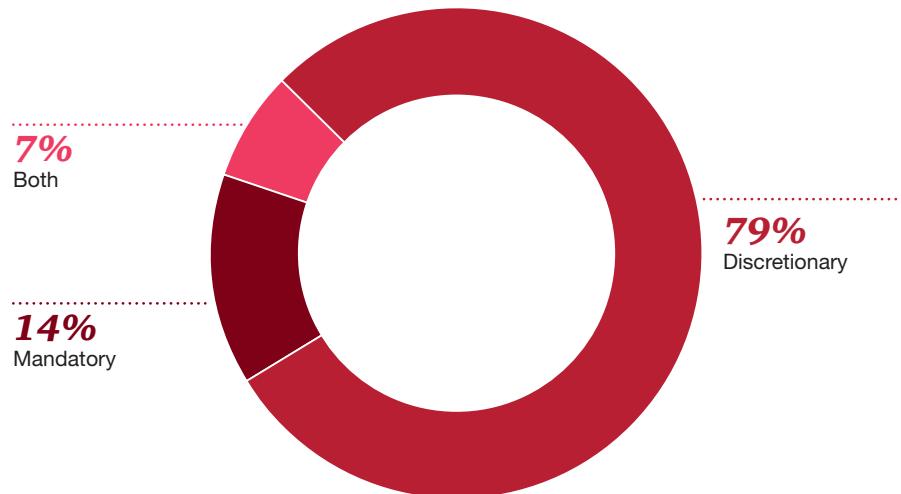
Companies often consider whether and to what extent to allow for discretion when structuring a clawback provision. As discussed earlier, certain types of discretion may lead to undesired accounting results (i.e., mark-to-market treatment). So any discretionary features should be carefully considered, and as always, it is important to include not only the HR/benefits team when developing new clawback provisions, but the finance/accounting team as well.

We found that in almost all cases, discretionary features are not included in the events that trigger a clawback. For example, we generally do not see provisions that provide blanket discretion for the Board or Compensation Committee to determine whether a clawback event has occurred.

However, we found many examples of discretion in determining the extent of recovery of compensation in cases where the triggering event has occurred. While some recoupment policies upon triggering of a clawback do not allow for discretion or judgment ("mandatory"), many others reserved the right to apply the recoupment policies on a case-by-case basis ("discretionary"). And some companies use both, depending on the clawback trigger ("both"). Discretion in a recoupment policy is typically not problematic for accounting purposes.

Of the 100 companies studied, 79% reserved discretion to determine whether or not to enforce their clawback policies on a case-by-case basis, 14% mandated the recovery of awards at the discovery of any clawback triggering behaviors or actions, and 7% reserved discretion to determine whether or not to enforce their clawback policies for certain clawback triggers or awards and mandated the recovery of awards for others.

### Discretion as to clawback enforcement



Below is an example of a clawback that appears to be mandatory:

*“[We] implemented the Executive Compensation Incentive Recoupment (Clawback) Policy during fiscal year 2009. Under the policy, the Committee requires all executive officers elected by the Board to reimburse any incentive awards if...”*

And one that is discretionary:

*“Under this policy, the Compensation Committee may seek to recover payments of incentive compensation if the performance results leading to the payment are later subject to a downward adjustment or restatement of financial or nonfinancial performance. The Committee may use its judgment in determining the amount to be recovered where the incentive compensation was awarded on a discretionary basis, as with awards under the Incentive Plan for fiscal year 2010.”*

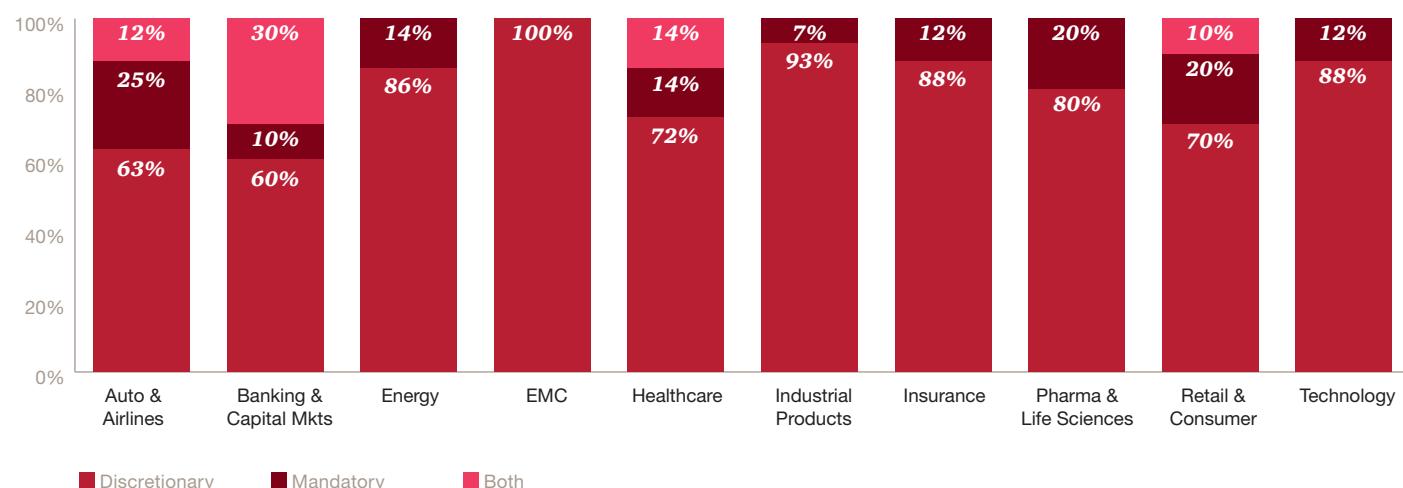
In 2012, one company from the healthcare payers sector described the discretion its compensation committee is provided:

*“The Compensation Committee does not believe it is possible to anticipate all possible scenarios in which recoupment might be appropriate and has retained discretion to evaluate each situation based on its individual facts. For example, there may be a case in which a supervisor’s failure to properly supervise an associate who commits fraud could be an omission serious enough to trigger the forfeiture provision for the supervisor as well as the associate. However, there could also be situations in which an associate’s actions will warrant forfeiture but the associate’s supervisor was neither negligent nor complicit with respect to those actions.*

*The Compensation Committee believes each situation should be examined on its individual facts in connection with determining when recoupment will be appropriate. The forfeiture provisions are designed to recognize that no two situations will be alike and to provide the Compensation Committee with the discretion necessary to invoke recoupment in a manner that is fair to both [the Company] and its associates.*

As shown below, sector results generally followed overall results with the majority of each industry sector’s companies incorporating discretion in their clawback policy.

#### Discretion as to clawback enforcement by sector

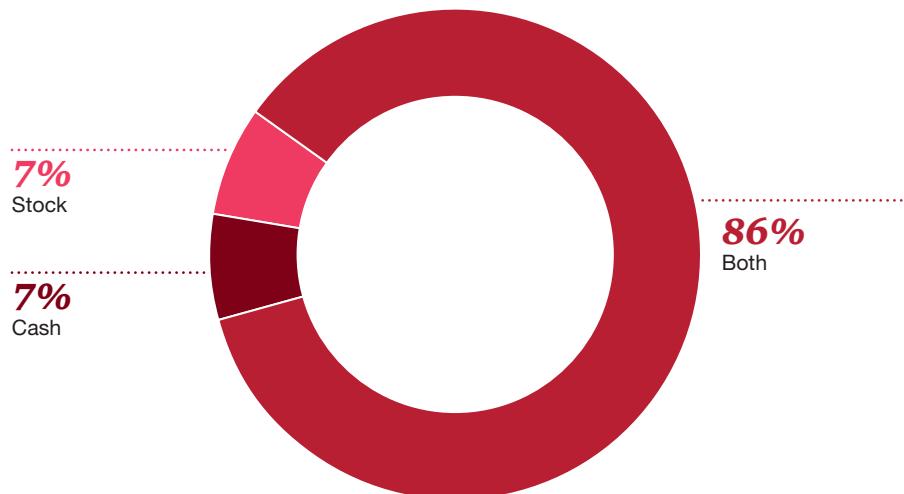


## Award types subject to clawbacks

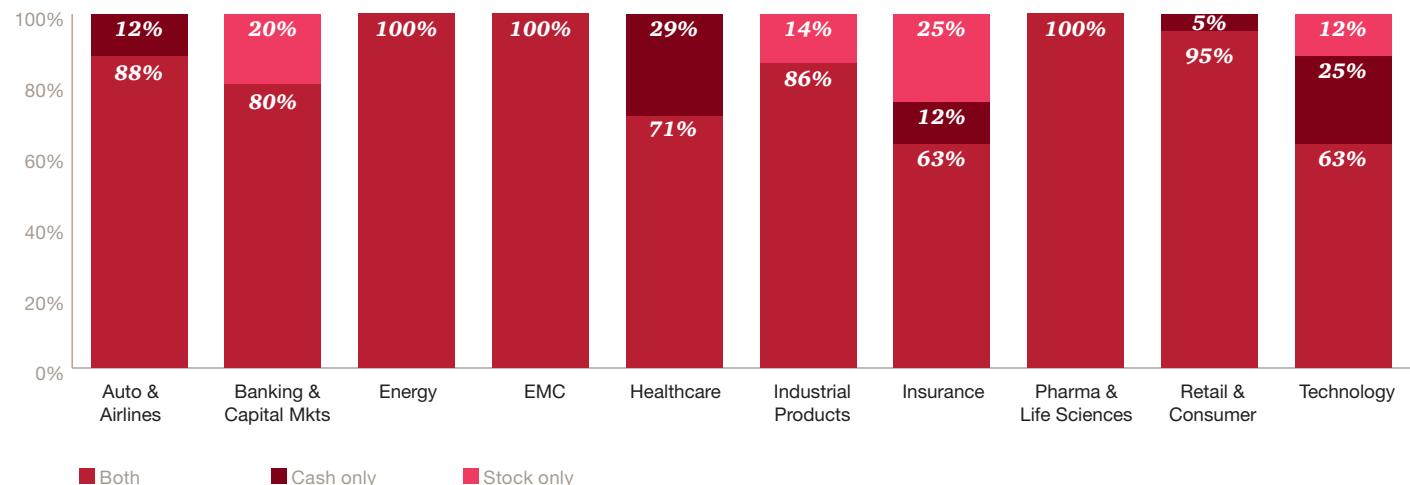
Awards subject to recoupment can be equity incentives (“stock”), cash bonuses, or a combination of both. The vast majority of companies studied (86%) may recover both cash and stock awards if clawback policies are triggered, while 7% of the companies studied only recover cash incentives and the remaining 7% only recover equity awards. Below is the breakdown of awards subject to clawback.

Sector results were similar to overall results, with 100% of the companies in three of the sectors reporting that both types of awards would be subject to a clawback. We found that 63% of the Technology and Insurance sector companies had clawback policies for both cash and stock compensation.

Type of awards subject to clawback



Type of awards subject to clawback by sector



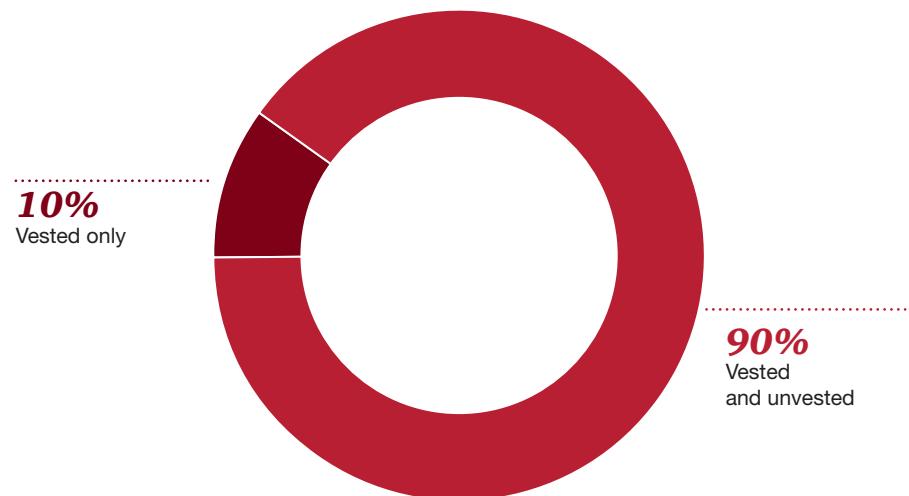
## Vesting status

Recoupment policies can apply to all awards, regardless of vesting status. While some companies may only recover awards that have not yet vested, other companies are likely to recover awards regardless of their vesting status. Of the companies studied, 90% of the companies may recoup awards regardless of whether the awards have vested, while 10% report recovery of only fully vested awards. Sector results generally followed overall results.

# 90%

*of the companies may recoup awards regardless of whether the awards have vested*

### Clawback of vested/unvested awards



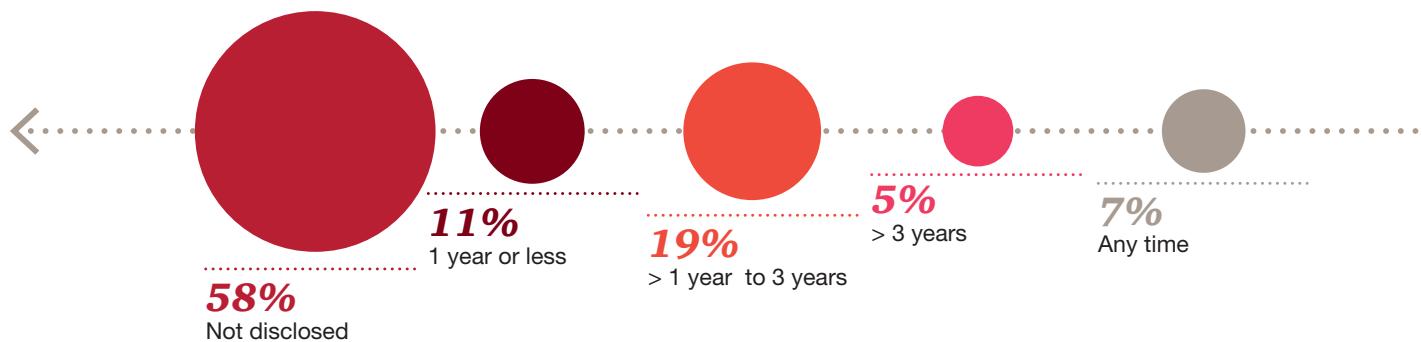
## Look-back period

Recoupment policies may apply to awards granted during a particular period of time prior to the clawback triggering event (“look-back” period). Of the 100 companies, only 42% disclosed or referenced any look-back periods. Of the companies describing a look-back period, the most common look-back periods were in the range of one to three years. Also of interest, 17% of the companies specifically indicated there was no limitation on the length of the look-back period.

# 42%

*of the 100 companies  
disclosed or referenced  
any look-back periods*

### Clawback look-back period



Below are examples of look-back provisions:

*“If an executive engages in any of the above “violation events”, any option gains realized over the two years before the event and the value of any restricted stock vesting over the year before the event are required to be paid back”*

*“In January 2013, the [clawback] policy was updated to provide an expanded definition of misconduct to include serious violations of the Code of Business Conduct & Ethics and violations of law within the scope of employment at the Company. In addition, the three-year discovery limit for misconduct was eliminated.”*

## Disclosure trends

The Dodd-Frank Act was enacted in July of 2010, but at the date of publication of this study, the SEC has not issued final rulemaking on the executive compensation clawback provisions of the law.

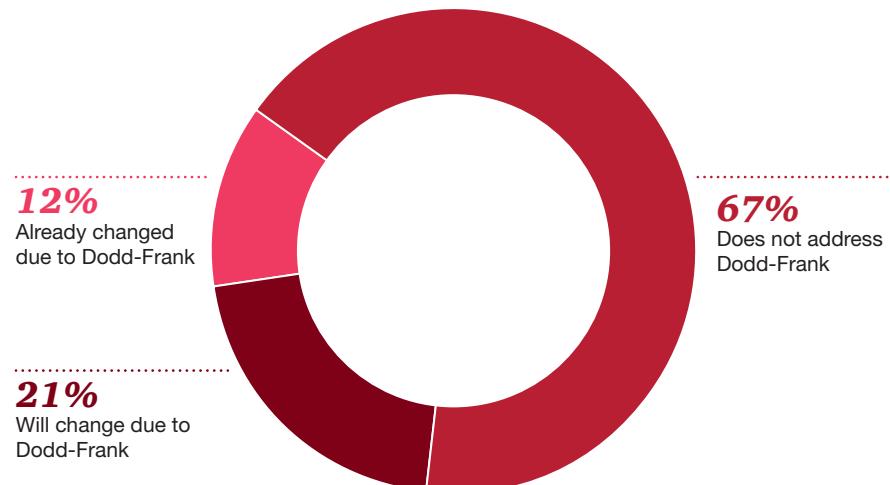
Only a combined 33% of the study population mentioned Dodd-Frank in relation to clawback policies. Overall we found 27% of the companies in our study made changes to their plans in 2012 in a meaningful way (such as describing a broader group of employees covered by the clawback policy, increasing the amount of potential clawback, or adding new reasons for a clawback). With Dodd-Frank affecting any company listed on a securities exchange, we expect that percentage to increase once the SEC issues its final rulemaking.

# 27%

*of the companies in our study made changes to their plans in 2012 in a meaningful way*

For the 100 companies studied, 67% do not reference Dodd-Frank in their proxy. Despite not having final guidance from the SEC, 12% of the study population indicated they have made changes to their clawback policies as a result of the Dodd-Frank Act.

### Dodd-Frank reference in clawback disclosure



## About PwC's human resource services practice

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Our expertise in tax, accounting, actuarial, finance, operations and compliance; our leadership in human capital management, measurement and program development; and our disciplined approach to execution and change sets us apart. With more than 6,000 HRS practitioners in 100 countries—including over 1,500 HRS practitioners in the US—PwC helps to align human capital strategies with business strategies and drive shareholder value for our clients.

PwC is at the forefront of understanding the strategic importance of human resources as a sustainable competitive advantage and has developed sophisticated methodologies to assess the entire human resources function, including

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