

MAYER|BROWN



DODD-FRANK CLAWBACK POLICIES ENFORCEMENT UNDER FOREIGN LAW

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Today's Speakers



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Aline Fidelis is the partner in charge of the Employment & Benefits practice group at Tauil & Chequer Advogados in association with Mayer Brown. She has extensive experience in strategic labor litigation and counseling, with over 20 years representing clients in the following sectors: oil & gas, capital markets, banking, education, life sciences, technology and energy, among others. She assists clients with her unique negotiation skills and ability to develop innovative solutions.



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Today's Speakers



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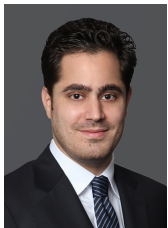
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Ryan Liebl is an Employment & Benefits partner in Mayer Brown's Chicago office. Ryan focuses his practice on advising public and private companies and individual executives on executive compensation related matters, including designing, drafting and administering nonqualified deferred compensation plans, excess benefit plans, equity compensation plans and agreements, cash-based incentive compensation plans and agreements, severance plans and individual employment and separation agreements.



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Jennifer Tam is a partner in the Employment & Benefits practice in Mayer Brown's Hong Kong office. Jennifer advises on all areas of employment law with an emphasis on contentious employment, discrimination, harassment and data privacy disputes. Jennifer has solid experience in handling high profile and complex employment litigation at various court levels from the Labour Tribunal to the Court of Final Appeal, handling investigations by and complaints to the Labour Department, Equal Opportunities Commission and the Office of the Privacy Commissioner for Personal Data of Hong Kong, advising on internal corporate investigations, disciplinary issues and termination of employment and dealing with trade unions and labour relations issues.

Agenda

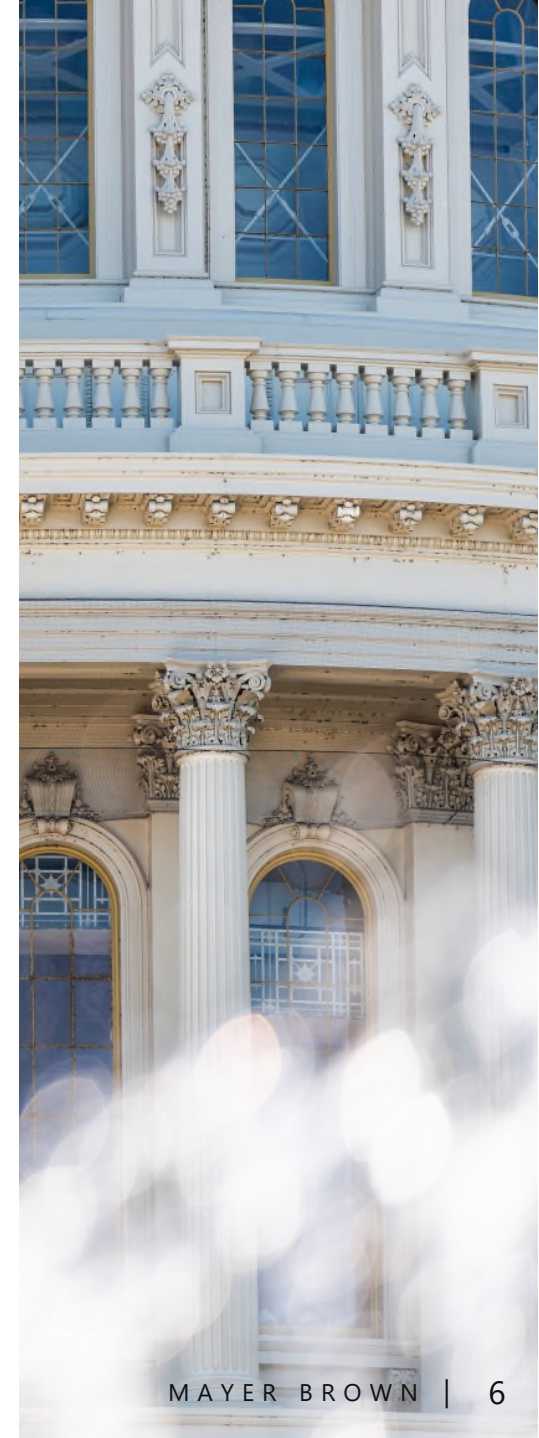
1. Overview of Dodd-Frank Clawback Rules for Companies Listed on US Exchanges
2. Application of Clawback Rules In the Following Foreign Jurisdictions:
 - Hong Kong
 - UAE
 - Germany
 - France
 - UK
 - Brazil
3. Questions?



**Overview of Dodd-Frank
Clawback Rules for
Companies Listed on US
Exchanges**

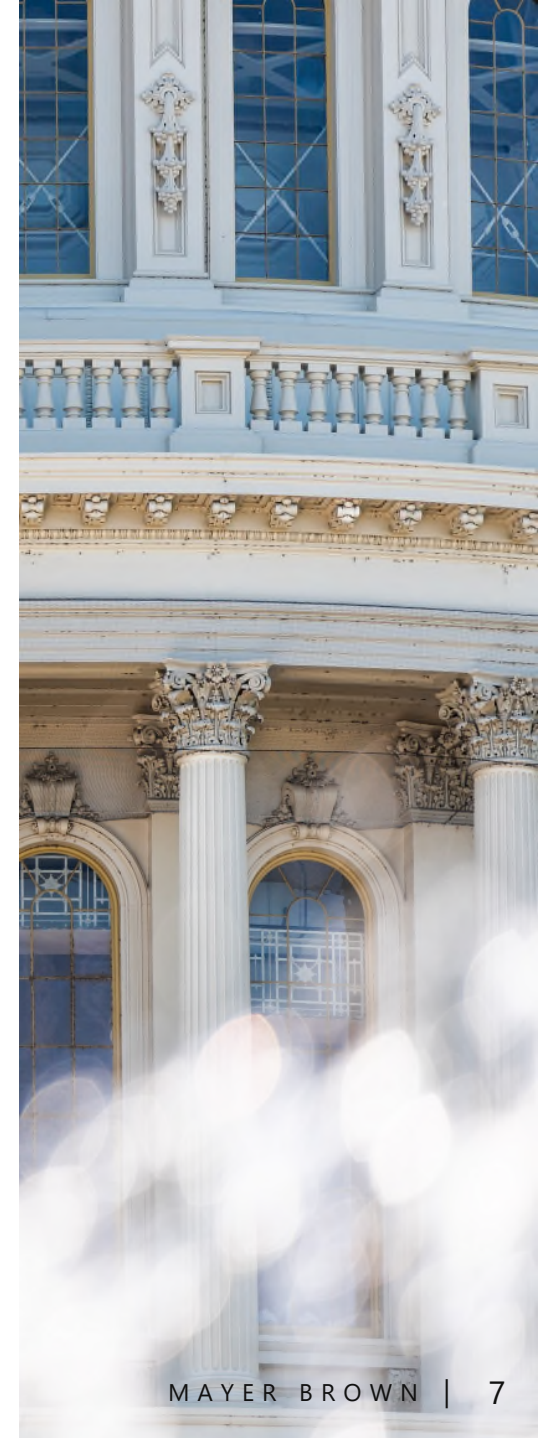
Background of Clawback Policies in the US

- Section 304 of the Sarbanes Oxley Act of 2002-SEC can sue for clawback of certain compensation of CEO and CFO for material restatement due to fault.
- Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) of 2010 added Section 10D to the Securities Exchange Act of 1934, requiring the SEC to direct national securities exchanges to establish listing standards that prohibit the listing of any security of a company that does not adopt and implement a written policy requiring the recovery, or “clawback,” of certain incentive-based executive compensation payments.
- On October 26, 2022, the US Securities and Exchange Commission (SEC) adopted new Rule 10D-1, directing national securities exchanges to establish listing standards that prohibit the listing of any security of a company that does not adopt and implement a written policy requiring the recovery, or “clawback,” of certain incentive-based executive compensation.
- SEC approved the final listing standards for NYSE and NASDAQ on June 9, 2023, with such standards becoming effective on October 2, 2023.
- Listed companies must adopt a compliant policy to be effective no later than December 1, 2023, that applies to all incentive-based compensation received on or after October 2, 2023.



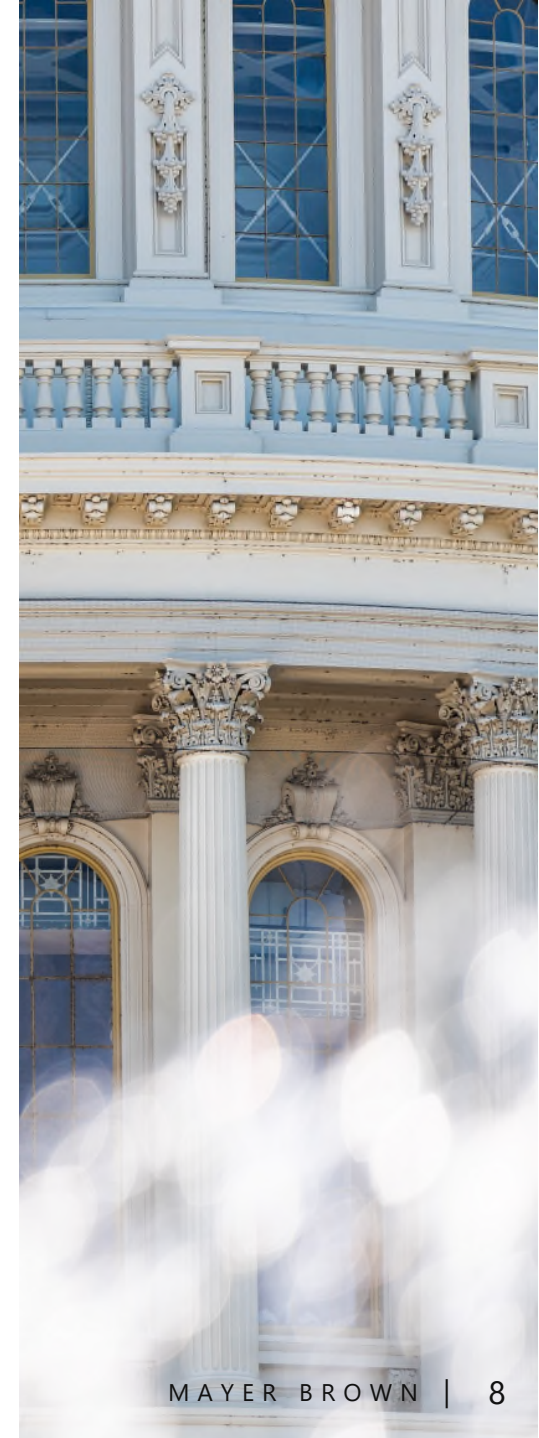
Why have an international panel on a US regulation?

- Listing standards apply to a Company that has a class of securities listed on a national securities exchange or a national securities association.
 - This can include companies that are incorporated in foreign jurisdictions or headquartered in foreign jurisdictions.
 - Many companies have executives who live and/or work in foreign jurisdictions (even partially).
 - Policy is enforced based on contract law not statutory provisions.
- Companies subject to the listing standards that may need to enforce the policy in a foreign jurisdiction need to consider any such issues now when drafting the policy (not later as it may be too late).



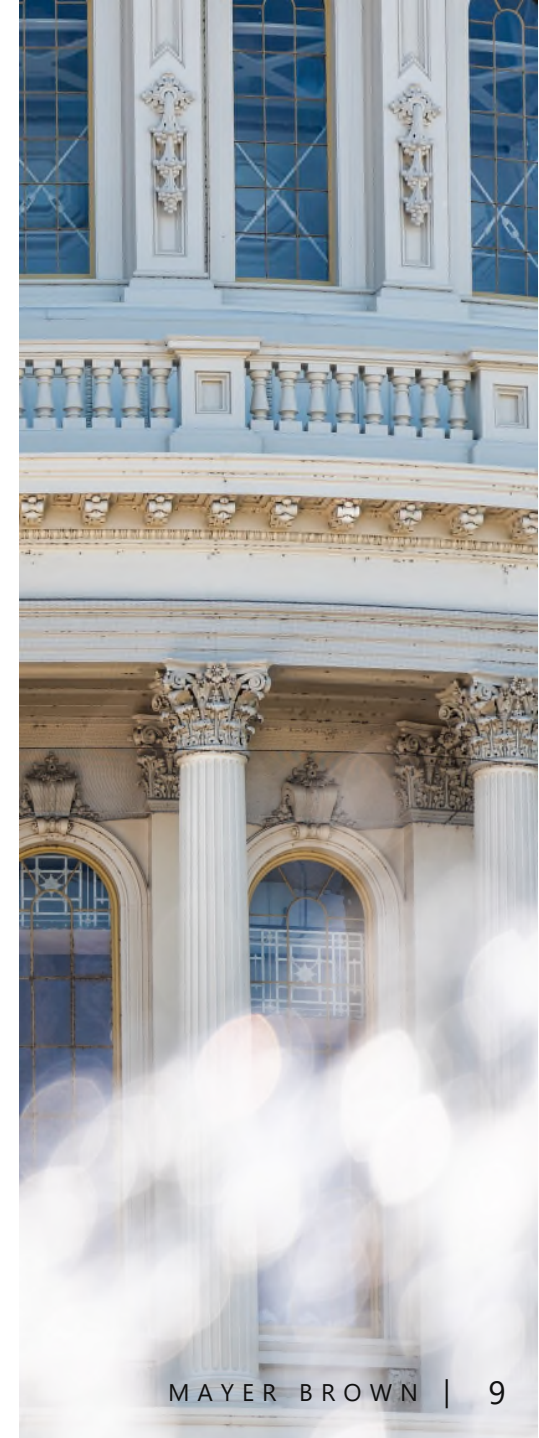
Overview of Requirements of Clawback Policy for Listing Standards

- General rule: Mandatory clawback in the event of a restatement of erroneously awarded compensation that was received by a covered executive officer.
 - No discretion on enforcement: only three limited exceptions (cost of enforcement exceeds recovery, home country law and tax-qualified plan)
 - No reduction for taxes paid by the Executives.
 - No indemnification of Executives.
 - No fault required.
- Key Concepts:
 - “Covered Executive” means all of the Company’s current and former executive officers using the Section 16 definition (generally includes “president, principal financial officer, principal accounting officer (or if there is no such accounting officer, the controller), any vice-president of the company 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 company]”).
 - “Erroneously Awarded Compensation” means the amount of Incentive-Based Compensation received by a Covered Executive that exceeds the amount of Incentive-Based Compensation that otherwise would have been received had it been determined based on the restated financial statements.



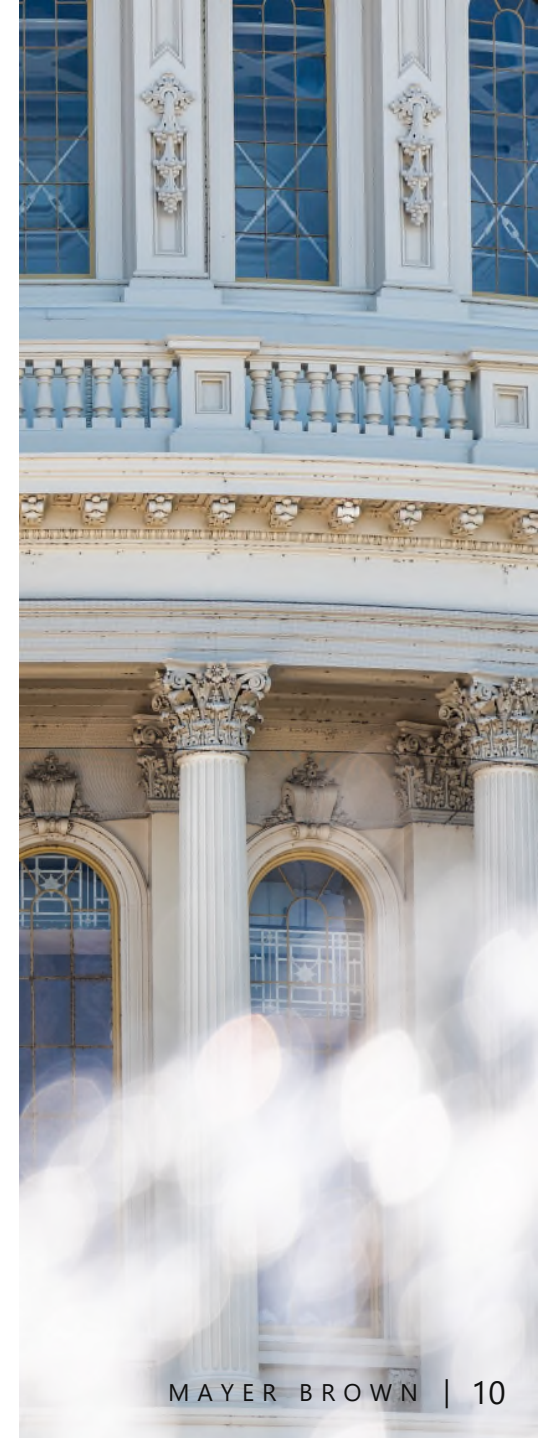
Overview of Requirements of Clawback Policy for Listing Standards

- Key Concepts:
 - “Incentive-Based Compensation” means all compensation (including cash bonuses or other cash incentive awards (including any deferred element thereof), and vested and unvested equity awards, including options, restricted stock and restricted stock units, performance stock unit awards and performance stock awards) from the Company or a subsidiary of the Company that is granted, earned, or vested based wholly or in part upon the attainment of a Financial Reporting Measure.
 - “Financial Reporting Measures” are measures that are determined and presented in accordance with the accounting principles used in preparing the Company’s financial statements, and any measures that are derived wholly or in part from such measures, including stock price and total shareholder return.
 - “Restatement” means an accounting restatement of the Company’s financial statements due to material noncompliance with any financial reporting requirement under the federal 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.



Key Considerations for Clawback Policy Provisions

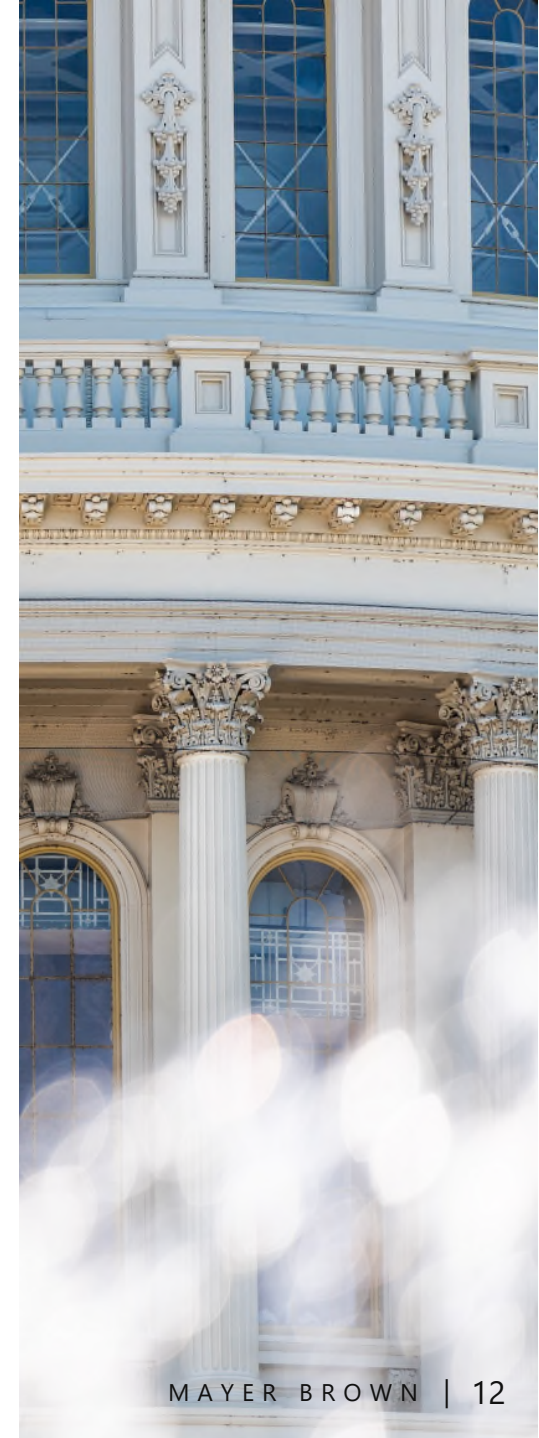
- Compliant clawback policy needs to be effective with respect to incentive-based compensation received on or after October 2, 2023 (policy can be adopted up to December 1, 2023).
- Consider having clawback policy permit offset of future compensation to satisfy clawback requirements (including compensation paid by subsidiary or affiliate). Also consider provision that permits suspension of payment of incentive-based compensation during period of uncertainty whether clawback may be required.
 - May make enforcement easier.
 - May have tax benefits for Executive (need to analyze at the time and be careful of 409A).
- Require covered executives to sign an acknowledgement letter (use future grants as consideration).
- Add a provision that makes clear that the terms of the clawback policy trump any other agreement between company and executive.



Hong Kong

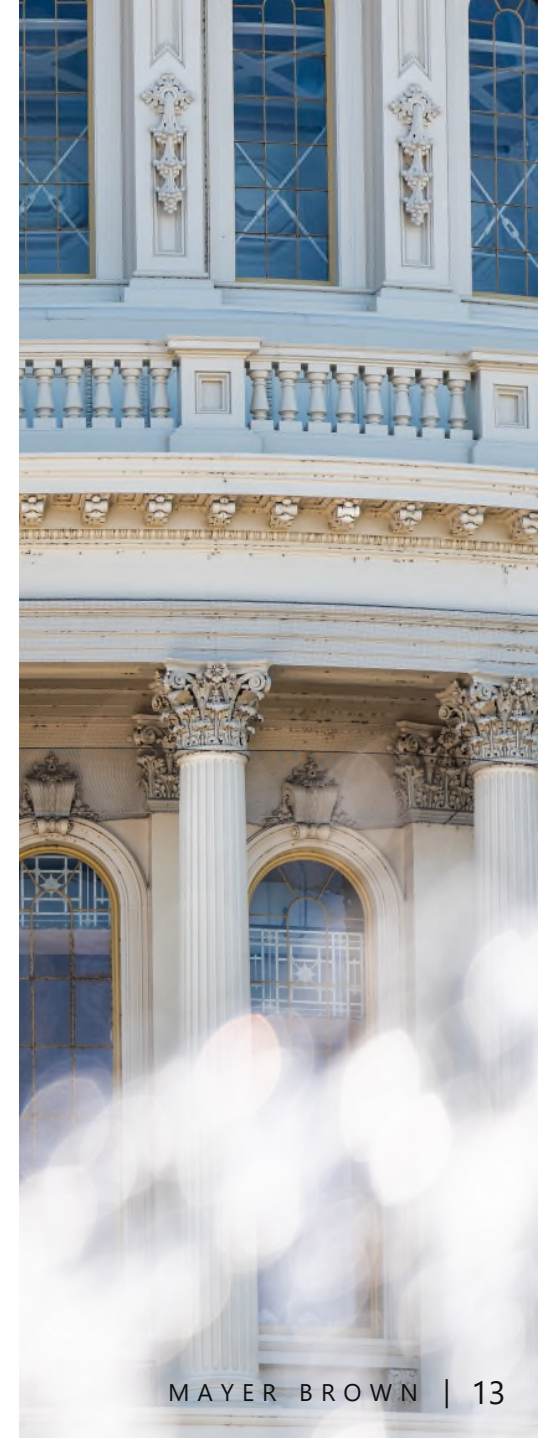
Hong Kong - Is a policy requiring the recovery of certain erroneously paid incentive-based executive compensation enforceable?

- No statutory “claw back” right
- Contractual right to recovery
- Guidelines for banking and insurance industries
 - **Hong Kong Monetary Authority (HKMA) Guidelines on a Sound Remuneration System Section 2.3.7:** If performance measurement was based on data that is (1) manifestly misstated, or (2) based on erroneous assumptions, then the remuneration policy of authorised institutions should allow remuneration to be adjusted before and after it is awarded to the employee
 - **Hong Kong Insurance Authority (HKIA) Guideline on Corporate Governance of Authorized Insurers:** Insurers should include “clawback” provisions for the unvested portion of the deferred remunerations if (1) the financial performance of the insurer is not genuine, or (2) the circumstance under which the performance is measured is not genuine



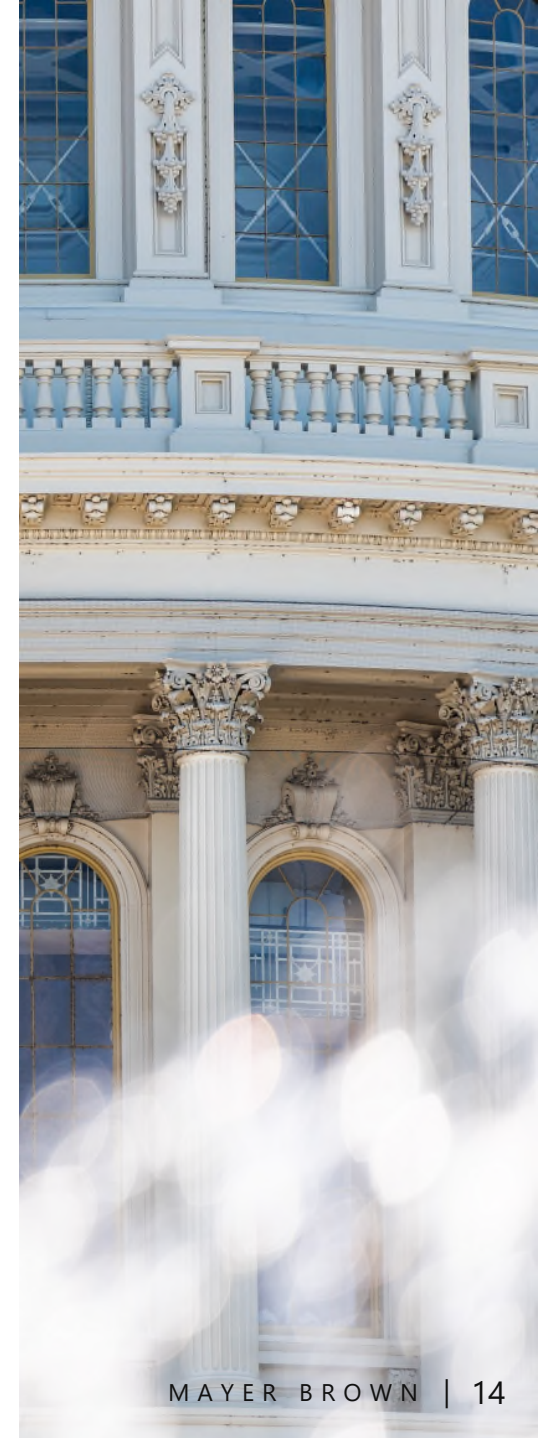
Hong Kong - Can an employer deduct certain erroneously paid incentive-based executive compensation from future compensation otherwise payable to the executive?

- Reduction vs deduction
- Section 32 Employment Ordinance: no deduction from wages and other payments
- Exception: recovery of overpayment of wages
 - Capped at $\frac{1}{4}$ of wages per wage period



Hong Kong - Provisions which an employer can add to a clawback policy to increase the likelihood of enforcement

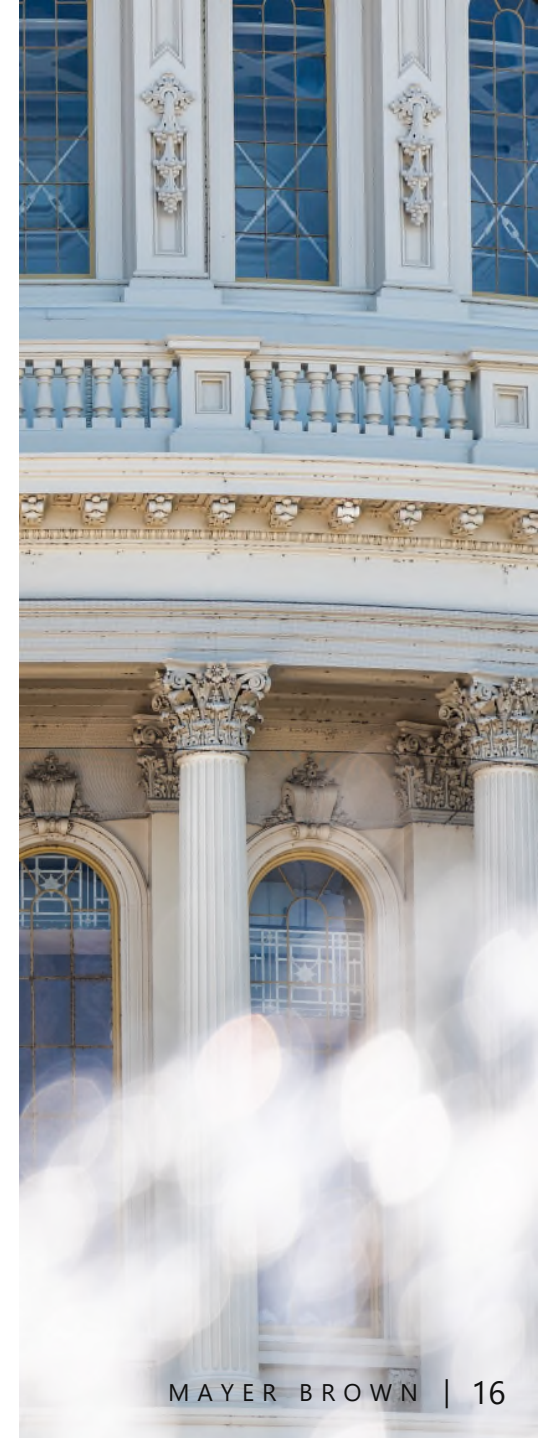
- Clawback and Malus provisions
 - Clawback: employee to pay back all or some of the amount received
 - Malus: to reduce or cancel any unpaid or unvested incentive compensation
- Define the trigger events clearly
- Retain discretion as to when the incentive was erroneously paid
- Ensure contractual right to enforce



UAE

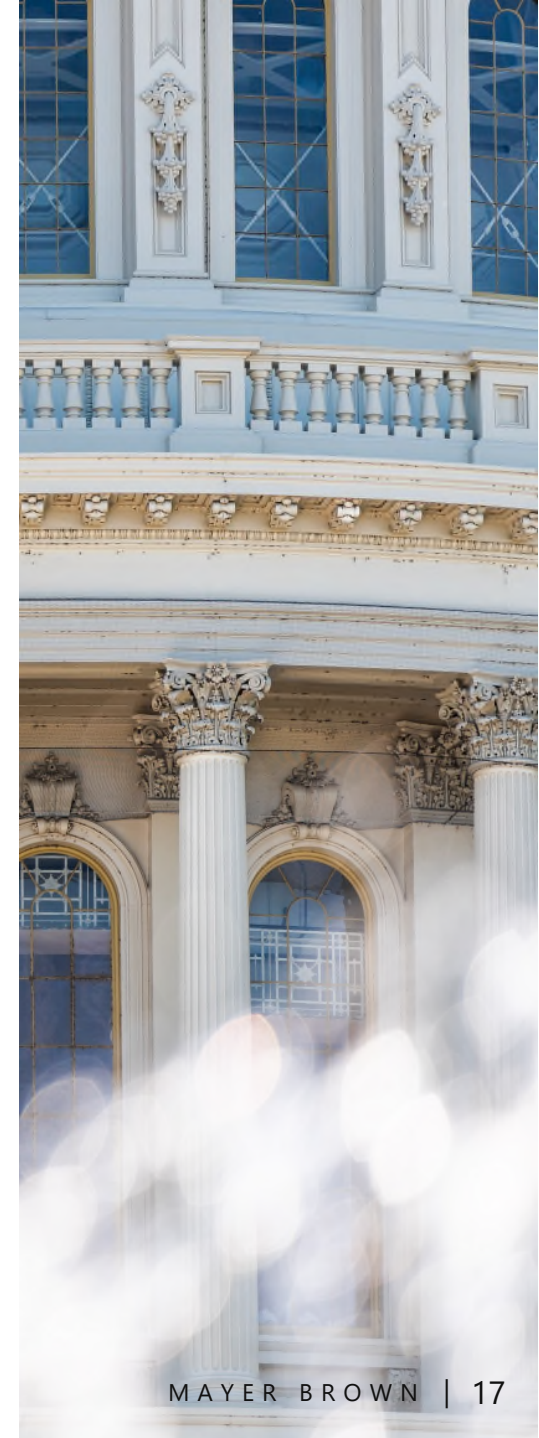
Enforcement of US Clawback Policies

- Overview on jurisdictions across the UAE.
- UAE Courts protective of employee rights.
- No local law prohibiting the enforcement of a policy requiring the recovery of certain erroneously paid incentive-based executive compensation.
- Article 25 of the UAE Labour Law No. 33 of 2021 provides for cases of deduction or withholding from an employee's salary including:
 - loans granted to employee;
 - contributions in bonuses, retirement pensions, saving funds and insurance;
 - participation in any social project provided by the employer;
 - debts due pursuant to judgments; and
 - employee's committed violations (not exceeding 5% of salary).
- Percentage of deduction and withholding must not exceed 50% of employee's salary.



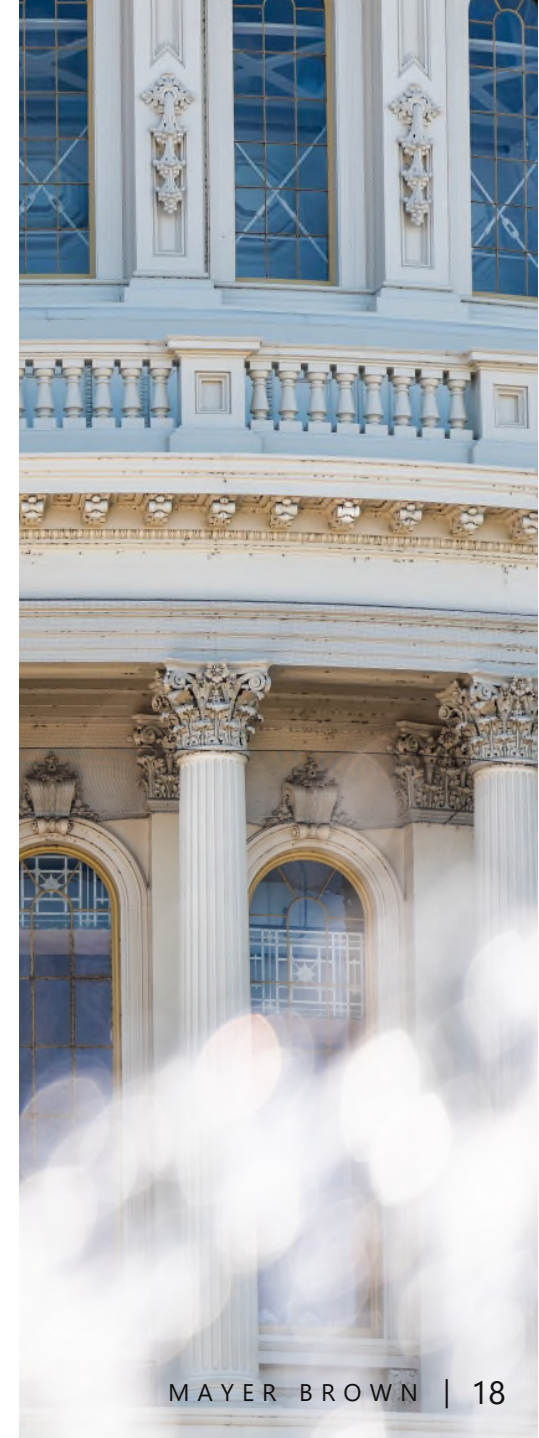
Deduction from Future Compensation (otherwise payable)

- No provision under local law that expressly prohibits companies from deducting erroneously paid incentive-based executive compensation from future compensation payable to the executive.
- This includes the deduction of overpaid bonus from future compensation or adjustment in other ways – “taking from other buckets.”
- Article 51 of the UAE Labour Law: An employer may deduct from an employee’s end of service benefits any amounts payable under law or by judgment.
- Importance of “termination letter.”



Provisions/Steps to Consider for Enforcement

- UAE “mandated” employment contracts for expats (in certain jurisdictions).
- Companies to consider dual employment contracts (as basis for enforcing US-based policies on local employees).
- Where possible, policies should include references to Article 25 of the UAE Labour Law (or free zone equivalent) when describing cases where an employer has a right to deduct amounts from an employee's compensation.
- Employers must be careful when drafting the policy such that it is not deemed a “penalty.” It should be clarified that deductions would not be in the form of penalties and would be made in accordance with the UAE Labour Law (or free zone equivalent).
- If by way of end of service – end of service acknowledgement (as part of termination letter) that there are no outstanding dues.



Germany

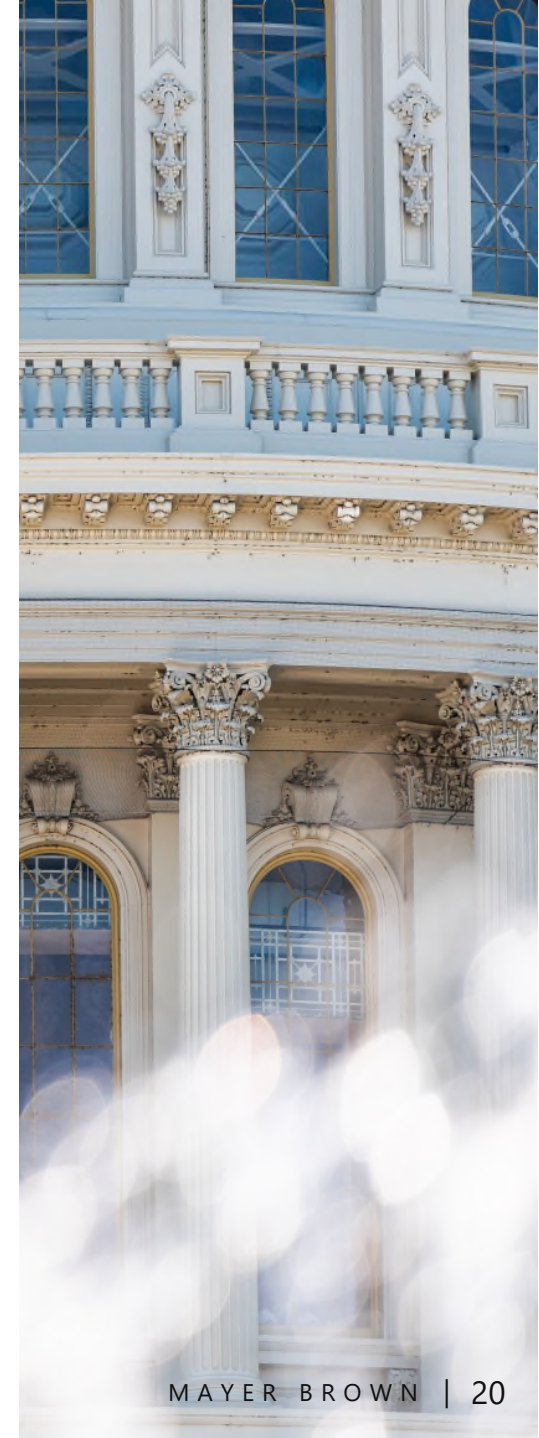
Enforcement of US Clawback Policies

General concept:

- German law does not *per se* prohibit the enforcement of a policy requiring the recovery of certain erroneously paid incentive-based executive compensation
- Strict requirements as to the transparency and clarity of clawback clauses result from the German law on general terms and conditions (Sec. 305 et seq. German Civil Code).
- Greater likelihood of enforceability of clawback rules if incentive plan is exclusively governed by US law – test under German law more likely applied to cash incentive plans; global plan preferable over local plan

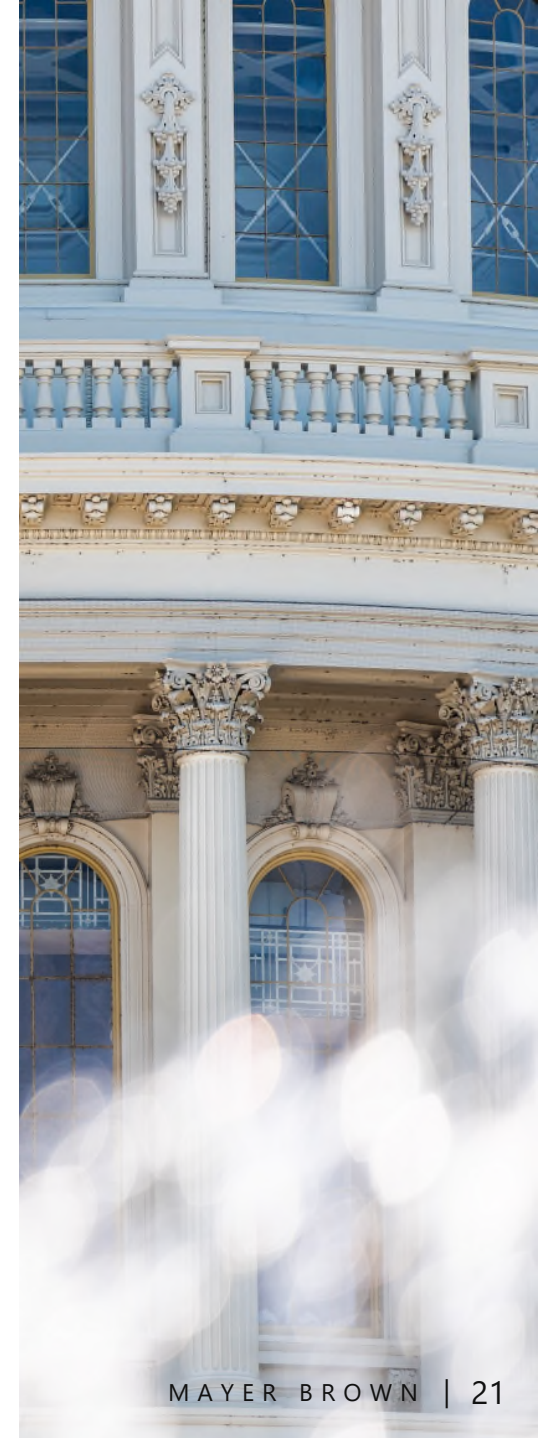
Special rules for banking and financial industry and stock corporations

- Special clawback rules (and requirements) apply to compensation schemes based on the EU Capital Requirements Directive, the German Banking Act, and the German Remuneration Ordinance for Institutions (includes “malus” and “clawback” requirements)
- Rules on compensation for supervisory and management board members in stock corporations offers additional flexibility to account for sustainable / long-term success



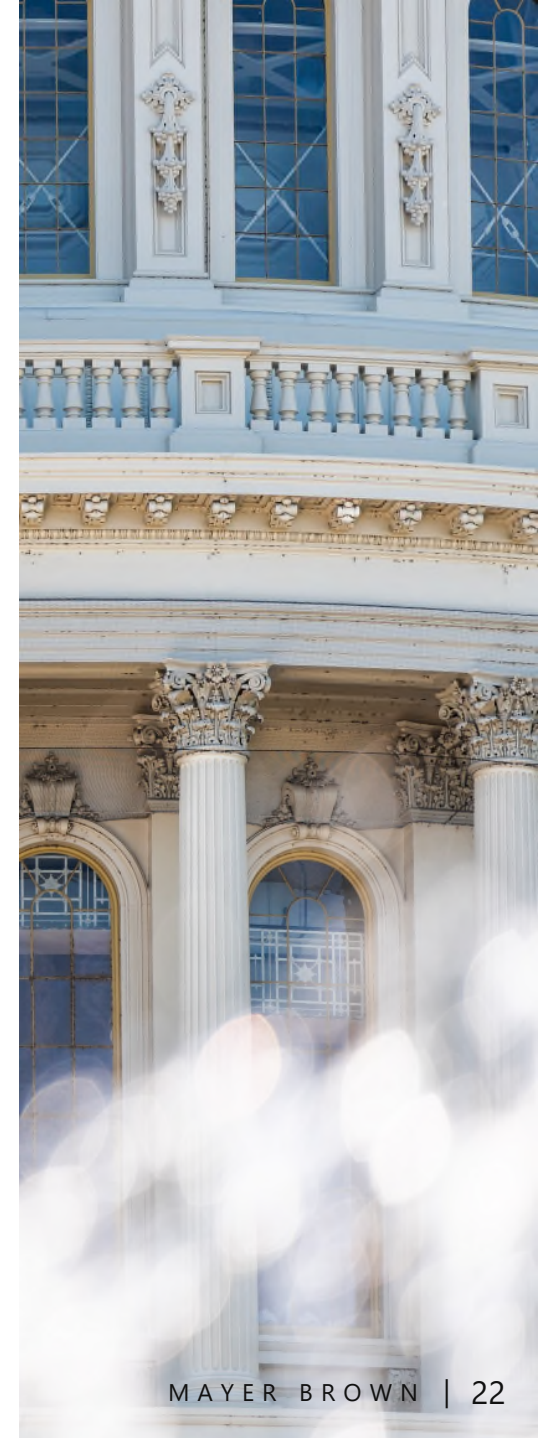
Deduction from Future Compensation (otherwise payable)

- No provision under German law that expressly prohibits companies from deducting erroneously paid incentive-based executive compensation from future compensation payable to the executive.
- Concept requires that entity claiming repayment and entity owing the future compensation are identical. Despite deduction, employee/executive needs be paid the so-called garnishment exemption amount (a lower 4-digit figure p.m.)
- Disputed whether deduction from gross / net payments



Provisions/Steps to Consider for Enforcement

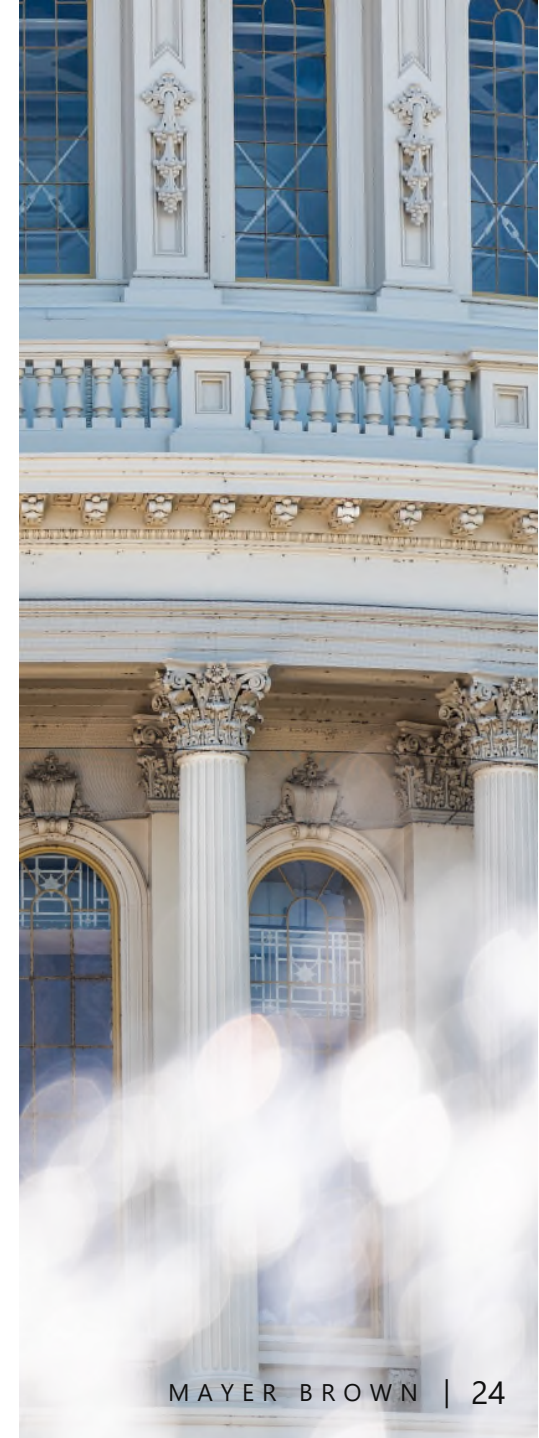
- Prefer global plan over localized plan
- Plan should be governed by US law, without involvement of local employer
- Clear reservation that payments remain subject to later correction in case of restatement of financial statements; preferable is time-limitation of such correction
- Plan should clearly describe under what circumstances clawback will apply.
- Clawback must not appear to be a penalty (*e.g.*, for low performance).
- Policy should clarify whether gross or net repayment
- Ideally insert reservation to offset repayment amount against future compensation entitlements
- Consider differentiation between clawback and malus



France

France: Impediments of the clawback enforcement

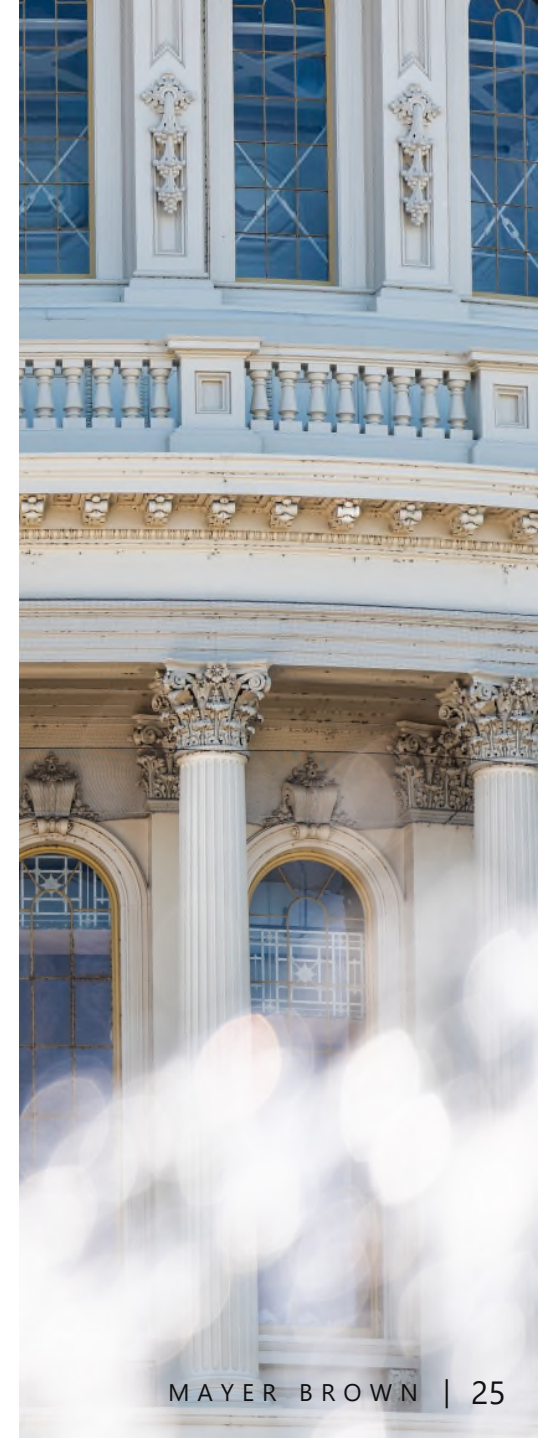
- **Prohibition of the pecuniary sanctions (Article L. 1331-2 of the Labor code)**
 - Any contrary provision is deemed null and void
 - Expansive view of prohibited financial sanctions by the Supreme Court, including when applied to non-disciplinary situations
 - No French specific case law on enforceability of the clawback mechanism provided by SEC rule related to listing standards. But given French Supreme Court's expansive view of financial sanctions, SEC clawback would likely fall within the general prohibition scope
- **Potential conflict with the imperative protection of fundamental rights under French law, particularly the right of ownership (*Supreme court, Civil Chamber, 15 Jan. 2020, n° 18-24.261*):**
 - This conflict occurs notably in the case of clawback on vested equity



France: Lawful claw back mechanisms (1/2)

- **Within the finance/bank sectors of activity**

- Claw back on variable remuneration is authorized
- Scope and conditions (Article L. 511-84 of the French monetary and financial code):
 - Scope: credit institutions, finance companies, payment institutions, electronic money institutions and investment management companies
 - **Qualifying acts: failure to comply with:**
 - **the rules** laid down by the company **with regard to risk-taking**, in particular when **significant losses for the company; or**
 - **obligations relating to honorability and competence.**
- Persons concerned:
 - *Members of the board of directors, the supervisory board or any other body exercising equivalent functions,*
 - *Employees managing the control functions of the establishment or major business units and reporting directly to the Board of Directors or any body exercising equivalent supervisory functions,*
 - *Employees (i) entitled during the previous financial year to a remuneration = or > EUR 500,000 and to the average remuneration paid to the directors and (ii) carrying out professional activities likely to significantly impact the risk profile of the operating unit they work in (Article L. 511-71 of the French monetary and financial code)*



France: Lawful claw back mechanisms (2/2)

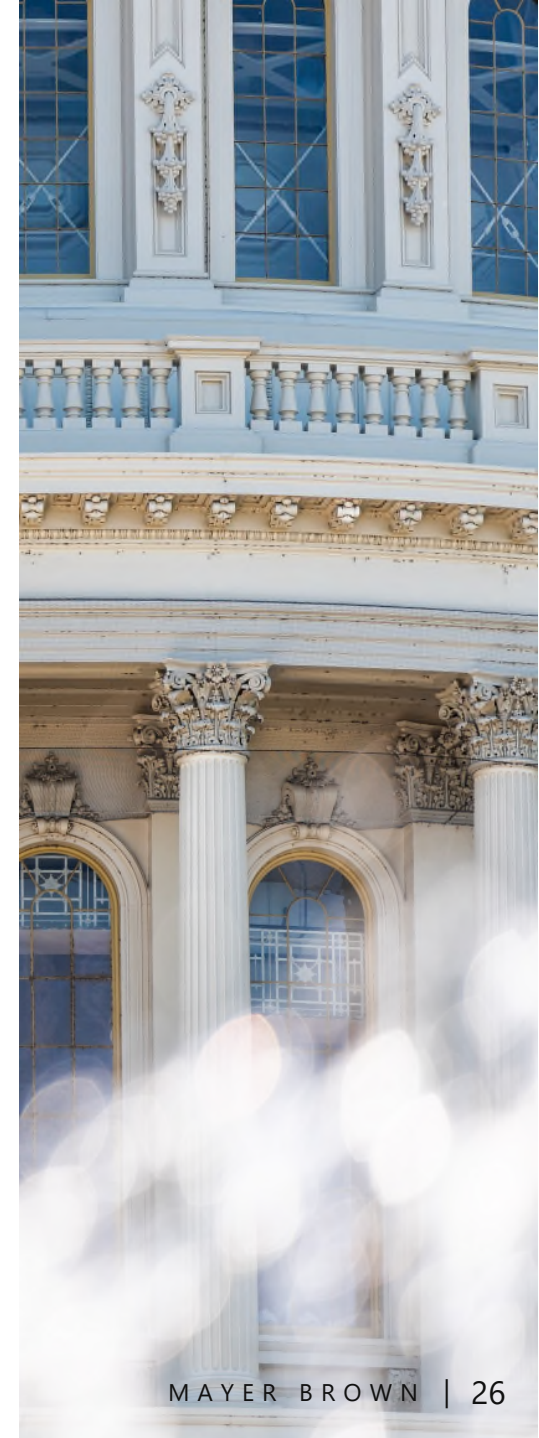
- **Within sectors of activity other than finance/bank**

Conditions of lawfulness:

- Never link the claw back to the employee's misconduct or to non-objective criteria: condition of presence is preferable (except for commissions)
- Specify clearly how the claw back triggering will apply
- Inform in writing the individual of the claw back at the same time as information on the variable compensation triggering event
- Terms of the claw back must not lead to actually preventing the employee from exercising their fundamental right of resigning, because of disproportionate importance of variable compensation (subject to the claw back) compared to the base salary or of unlimited (or too lengthy) applicability
- Clause must (i) be written in French, when provided by the employer or (ii) provide for a clear and full acknowledgment/understanding statement to be filled in and signed by the individual, when the clause is written in English.

- **Whatever the sector of activity**

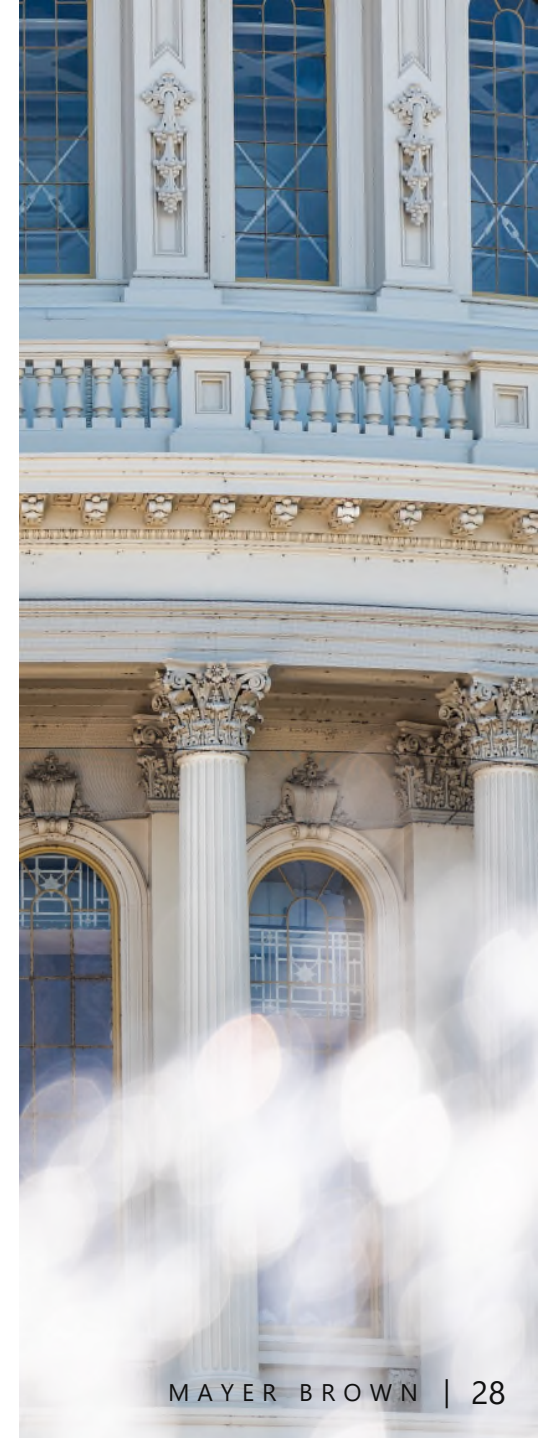
Payment errors do not create enforceable rights (*Supreme Court, 17 May 2011, n°10-12.852*)



UK

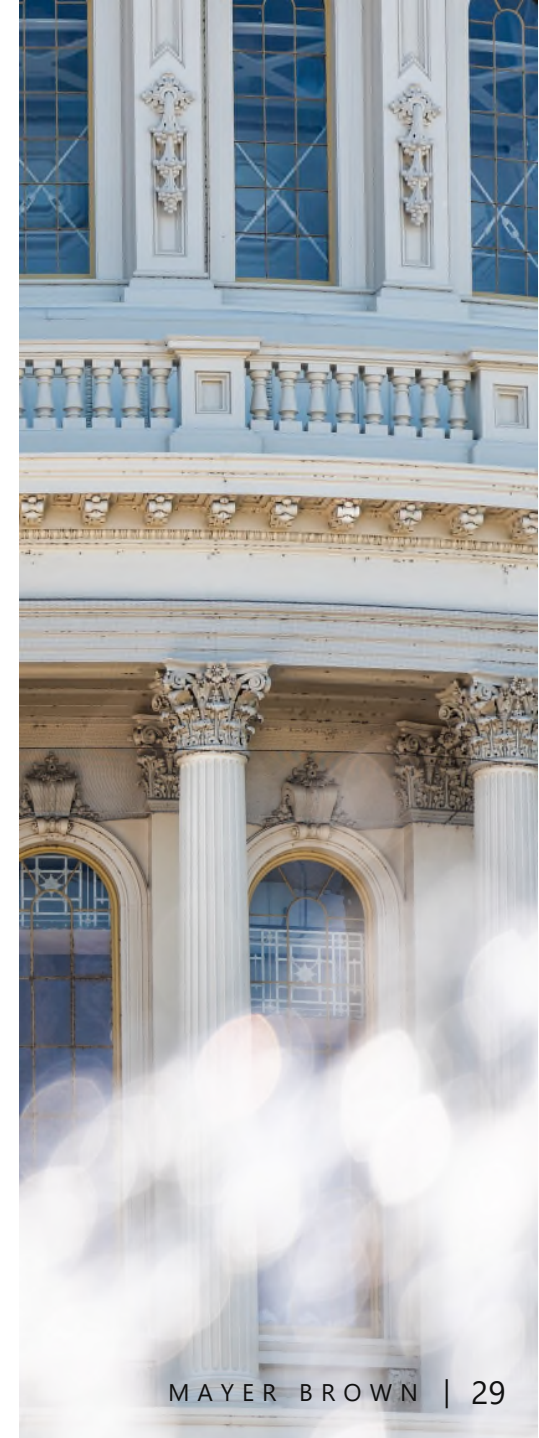
Clawback in the UK

- Clawback policies are commonplace in UK, in particular:
 - financial services firms subject to Remuneration Codes
 - listed companies subject to the UK Corporate Governance Code
- Two forms of clawback: malus (forfeiture of unvested/undelivered awards awards) and clawback (repayment of vested/delivered awards)
- Trigger events tend to be broad: e.g. misstatement of results, misconduct, reputational damage, corporate failure.
- But these Codes do not have the force of law and companies must give them contractual force in the incentive plan documents.



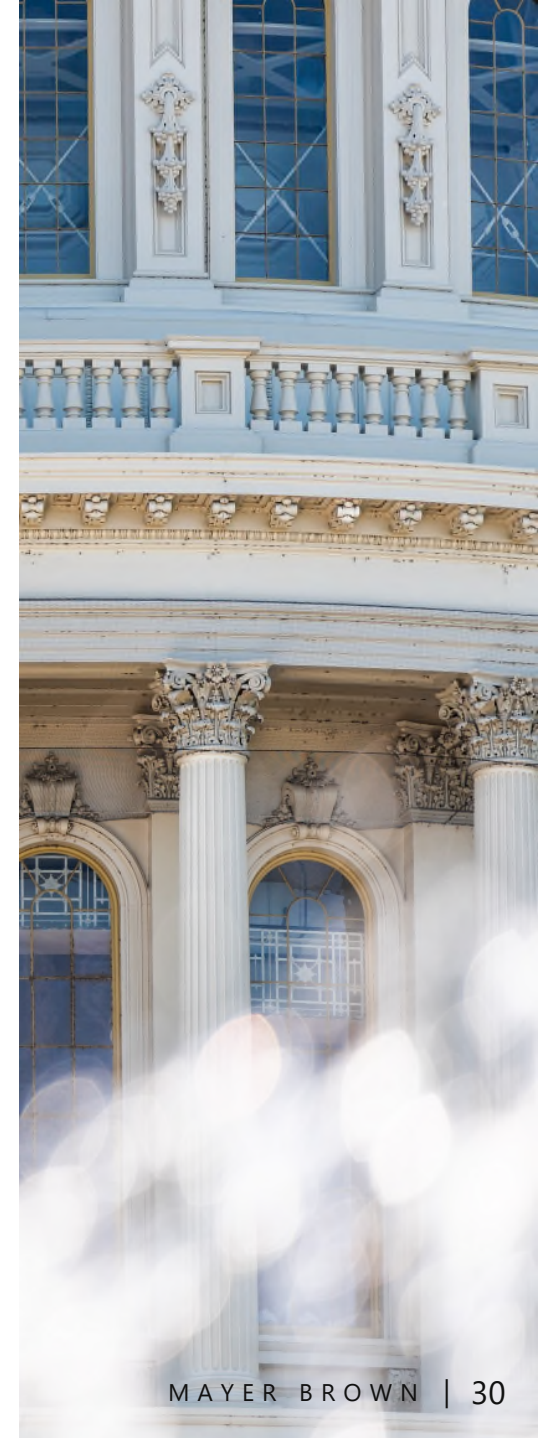
Enforcing clawback

- Amounts due from an employee can be deducted from future remuneration provided they have agreed to deductions being made in writing, usually in the award agreement.
- 'Cross-clawback':
 - clawback against one award achieved by forfeiture of another award, possibly under a different incentive plan
 - can provide a simpler enforcement method and may reduce tax issues
 - consider which other awards to claw back, eg by reference to size, likelihood of vesting, how close to vesting date.



Drafting points

- Clawback triggers: consider whether to draft broadly or narrowly. Courts will be restrictive and will not permit clawback where not clearly provided for in the plan.
- Cross-clawback: need to draft relevant provisions into both incentive plans and obtain express agreement from the employee.
- Keep minutes showing rationale behind the decision: otherwise participants may challenge whether company has acted consistently and reasonably.



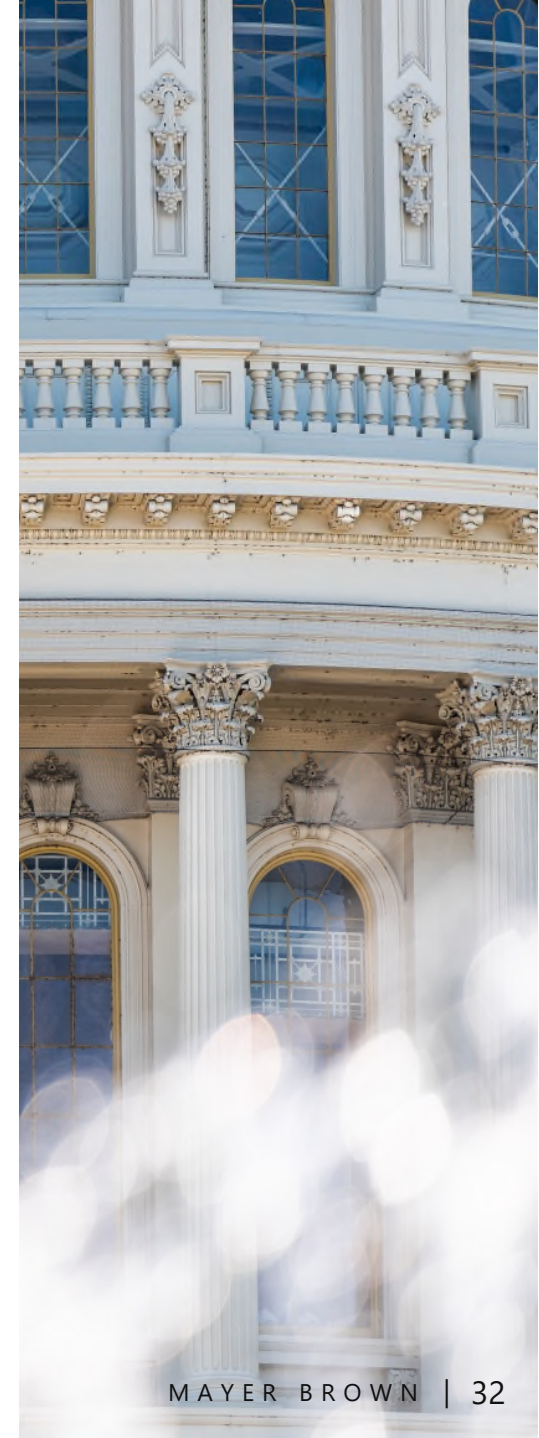
Brazil

Brazilian Law on Clawback Policies

The recovery of incorrectly dispensed compensation

Non-Employee Officer	Employee
<p>✓ Possibility of clawback policies/contract clauses.</p> <ul style="list-style-type: none">• A policy requiring the recovery of certain erroneously paid incentive-based executive compensation is enforceable under Brazilian Law.	<p>! The Brazilian Labor Code (“CLT”) distinctly forbids deductions from salary that lack a justifiable basis.</p> <ul style="list-style-type: none">• It is incumbent upon the employer to validate the occurrence of the oversight.• It is requisite to duly inform the employee of the said oversight.• Upon employee’s agreement, the employer may deduct the differential amount, following the methods provided by law applicable to an advance payment.

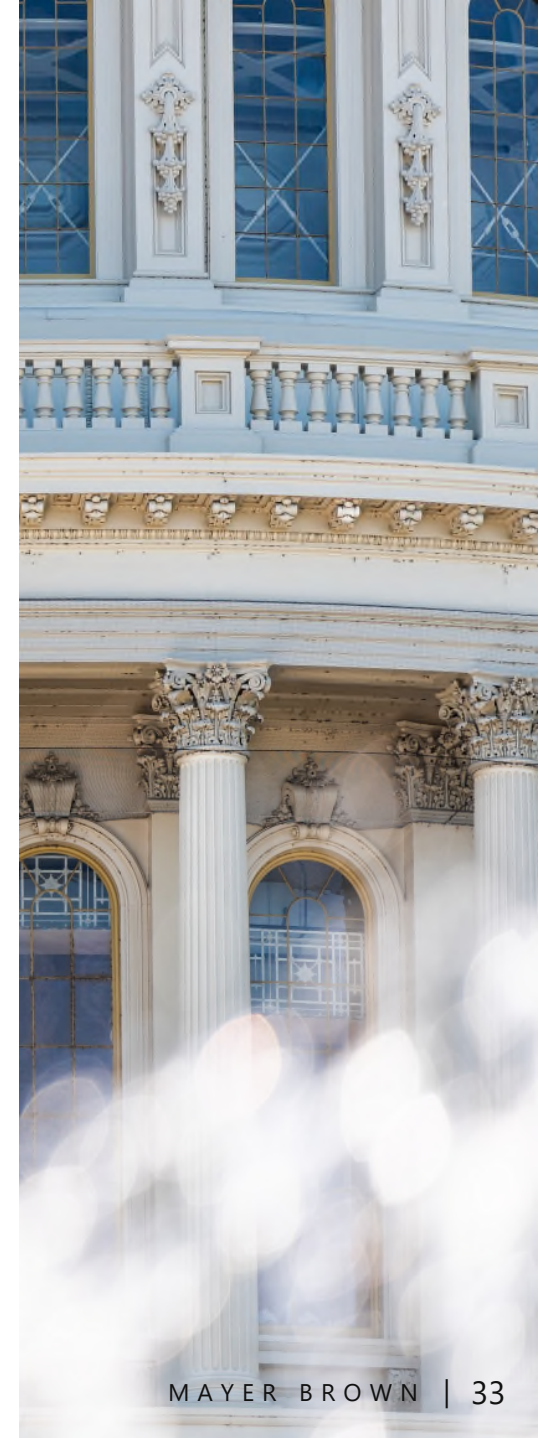
* Pursuant to Article 3 of the CLT, an **employee** is defined as an individual who renders services on a regular basis, under subordination (*i.e.* subject to direct oversight) and dependency to his/her employer, against receipt of salary.



Brazilian Law on Clawback Policies

On deductions from subsequent compensation - Brazilian Law No. 10,820/2003:

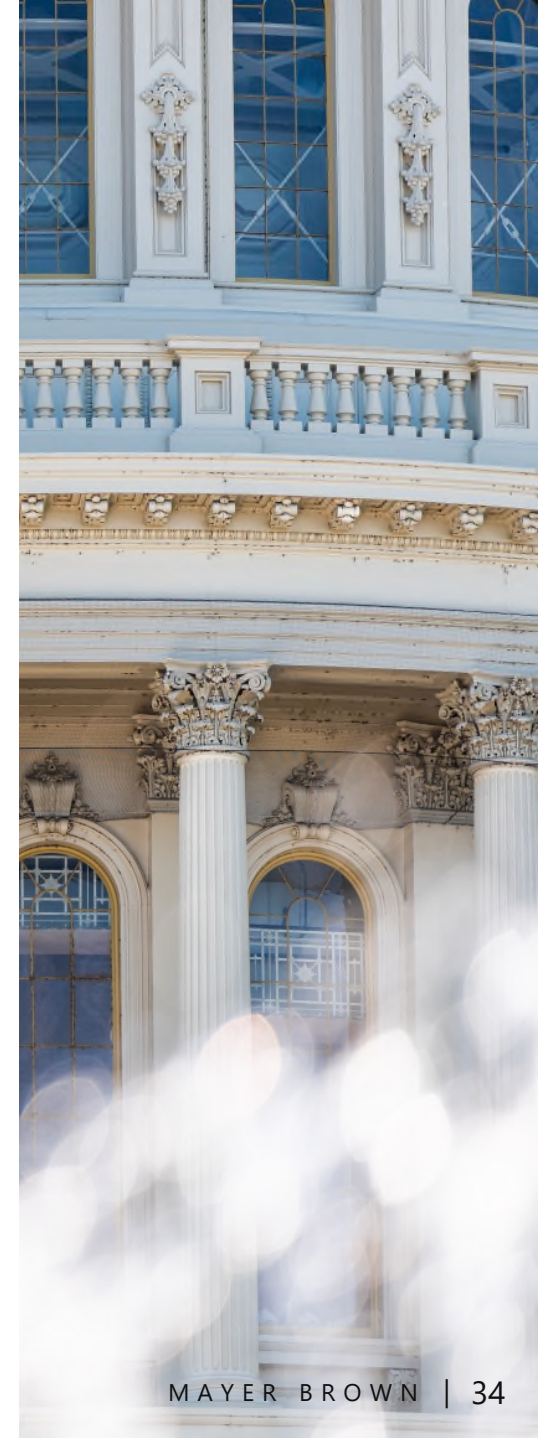
- Subject to the unequivocal authorization from the employee and their acknowledgment of the oversight:
 - Erroneously paid compensation may be deemed as payment in advance and upon the employee's express authorization and recognition of the error, the employer may deduct only up to 30% of the employee's monthly salary.
 - As a practical effect of this change, companies may require the return of incentives (bonuses, PLR, stock options, etc.) advanced to executives to offset significant and measurable losses to the company due to misconduct in the management of the business. For proven willful misconduct, there is an express provision in the CLT regarding the possibility of reimbursement from the employee.
 - This procedure is similar to the rules set forth in article 462, paragraph 1 of the CLT. More precisely, the difference between the discount set forth in that article and the effects provided in the clawback is merely practical, since both mechanisms have the same substantive nature. Instead of clawing back previous incentives advanced to executives, the article in the CLT provides for discounts from future compensation (including bonuses, if eligible) for losses caused. The essence, however, is the same: recovering pecuniary damages caused by employees by reason of misconduct, whether willful.



Brazilian Law on Clawback Policies

Provisions to increase the probability of Clawback Policy enforcement:

- Specific provisions geared towards enhancing the likelihood of policy enforcement should be more conspicuously present. The policy must comprehensively enunciate the following:
 - The internal modalities and mechanisms ensure adherence to the law.
 - Previous communication stratagems with the contracted employee/non-employee officer.
 - The methodologies employed for the acquisition of requisite authorizations.
 - For non-employee member of board of directors (under US labor jurisdiction): Listed companies under clawback standards proposed by the New York Stock Exchange (NYSE) and the Nasdaq Stock Market (Nasdaq) should determine the schedule for presentation of clawback materials to their respective board of directors.



Questions?



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