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Client Alert Commentary

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Nasdaq and NYSE File Proposed Listing Standards for Clawback Rules

The proposals align with the SEC's recent rule related to the recovery of erroneously awarded incentive compensation.

On February 22, 2023, the Nasdaq Stock Market LLC (Nasdaq) and New York Stock Exchange LLC (NYSE) each filed proposed listing standards with the US Securities and Exchange Commission (SEC) related to the clawback of erroneously awarded executive compensation as required under Rule 10D-1 under the Securities Exchange Act of 1934. This rule, in part, directs stock exchanges to require issuers that are publicly listed in the US to adopt clawback policies that comply with Rule 10D-1. For a full summary of the SEC's clawback rule, see this Client Alert.

Issuers subject to the proposed listing standards will be required to adopt a compensation recovery policy no later than 60 days following the date on which the applicable listing standards become effective. While the date when the listing rules become effective is still uncertain, under the SEC's rule they must become effective no later than November 28, 2023, but the effective date could be earlier.

If approved by the SEC, the Nasdaq proposal will become a new Nasdaq listing Rule 5608 and the NYSE proposal will become new Section 303A.14 in the NYSE Listed Company Manual. Both proposals conform closely to the language in Rule 10D-1 with some enhancements. This Client Alert summarizes the nuances in the stock exchange proposals that will apply to companies listed on each exchange.

As a reminder, if the NYSE or Nasdaq notify an issuer that it does not satisfy a listing standard or that the exchange will commence delisting proceedings, the issuer must disclose the noncompliance on Form 8-K. Similarly, if the issuer is aware of any material noncompliance with the listing standard, such noncompliance will trigger the filing of a Form 8-K.

- **Clarification of the "reasonably promptly" standard.** Rule 10D-1(b)(1) requires issuers to recover excess incentive compensation reasonably promptly but does not specify the actual timing of recovery. Nasdaq and NYSE will use a holistic approach to assess whether an issuer's recovery meets the "reasonably promptly" standard by considering whether the issuer's recovery efforts strike a balance of cost versus speed and whether such efforts are appropriate in light of the facts and circumstances surrounding the recovery. While Nasdaq and NYSE elected not to prescribe strict timing requirements for compensation recovery, the exchanges are permitted to adopt more prescriptive approaches to the timing and method of recovery.

The exchanges may amend the holistic timing requirements after observing issuer performance, to the extent that they assess the need for further guidelines to ensure prompt and effective recovery. For now, issuers retain the latitude to determine the best approach to compensation recovery based on the facts and circumstances applicable to the issuer and the executive officer. However, issuers will need to ensure that recovery efforts align with fiduciary duties under state law to safeguard the assets of the issuer, including the time value of any potentially recoverable compensation that belongs to the company rather than the executive officers who erroneously received it.

- **Noncompliance with Nasdaq rule.** Issuers listed on Nasdaq that fail to comply with the new compensation recovery listing standard will be subject to delisting and must follow an administrative process that generally reflects the established pattern for similar corporate governance deficiencies. Such issuers will be required to submit a compliance plan to Nasdaq staff, which could then provide the issuer up to 180 days to cure the deficiency. However, Nasdaq staff will not be permitted to issue a public reprimand letter for violations of listing standards required by Rule 10D-1. Instead, Nasdaq staff will be required to issue a Staff Delisting Determination Letter that the issuer could appeal to the Hearings Panel. The Hearings Panel could extend the issuer an additional 180 days to cure the deficiency.

- **Noncompliance with NYSE rule.**

  - <u>Failure to timely adopt clawback policy</u>. Issuers that fail to adopt a clawback policy within 60 days of the effective date of the listing standard (a Delinquency) will promptly receive a written Delinquency notification. Within five days of receipt of the notification, the issuer will need to contact the NYSE to discuss the status of the Delinquency and issue a press release disclosing the occurrence, reason for the Delinquency, and, if known, the anticipated cure date. If the issuer fails to timely issue the press release, the NYSE will issue a press release stating the issuer has incurred the Delinquency. The NYSE may elect to commence immediate suspension and delisting proceedings or may provide the issuer with a six-month cure period from the Delinquency. During this cure period, the NYSE will monitor the issuer and the status of the delayed clawback policy. Following the cure period, the NYSE will have discretion to allow the issuer's securities to be traded for up to an additional six months or to initiate suspension and delisting procedures.

  - <u>Failure to recovery erroneously awarded compensation</u>. Issuers that, in the NYSE's determination, do not recover erroneously awarded compensation pursuant to the issuer's clawback policy reasonably promptly will face immediate suspension of all listed securities followed by the commencement of delisting procedures.

- **Public comment.** Public comment is requested no later than 21 days following publication of the proposed listing standards in the Federal Register. The SEC has up to 90 days following the date of publication to approve or disapprove the proposed listing standards or to institute proceedings to determine whether the proposed listing standards should be disapproved.

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