

Professional Perspective

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Considerations for Incentive Pay & Clawback Provisions

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In March 2023, Deputy Attorney General Lisa Monaco and Assistant Attorney General Kenneth Polite of the Criminal Division announced a three-year [Pilot Program on Compensation Incentives and Clawbacks](#). The Pilot Program comprises two components.

First, all DOJ Criminal Division corporate resolutions will include mandates to adopt compliance-related compensation and bonus criteria, such as withholding bonuses from employees who violate laws, and providing “incentives” for employees who “demonstrate full commitment to compliance processes.” Second, in certain circumstances, DOJ will offer a discount against a company’s criminal penalty equal to the amount of prior compensation clawed back from non-compliant employees and supervisors.

The Pilot Program was accompanied by revisions to the Criminal Division’s [Evaluation of Corporate Compliance Programs](#) (ECCP) document, which continues to emphasize that a “hallmark of effective implementation of a compliance program is the establishment of incentives for compliance and disincentives for non-compliance,” and suggests factors by which a company’s compensation structures should be assessed.

This article offers practical guidance for companies looking to stay ahead of the curve on the use of compensation mechanisms to incentivize compliance and disincentivize non-compliance. Companies should consider the suggestions below as potential starting points.

Insights From Employment Law

What Compensation Might a Clawback Policy or Other Compliance Measures Affect?

Employee benefits and compensation principles are an important starting point for companies considering clawback programs. As a general matter, compensation clawbacks and other compliance-related compensation consequences are more likely to affect incentive compensation –e.g., merit bonuses, stock grants, and long-term incentive awards–than base salaries and wages. Indeed, in most jurisdictions, base wages are legally protected and cannot be withheld after being earned.

Clawback policies—even those adopted by companies at the behest of federal enforcers—generally are contractual in nature, and do not supplant local law. For this reason, in jurisdictions that protect base salaries and wages, rank-and-file employees should not expect to have their regular paychecks docked for compliance violations, although misconduct may result in other disciplinary action, including termination.

Companies accordingly will generally have the greatest ability to implement compensation consequences with respect to employees whose compensation is, at least in part, contingent and incentive-based. Often, those individuals are executives and other senior management, but certain companies offer variable or other supplemental compensation on a broader basis, including, for example, to salespeople.

Although compensation clawbacks perhaps garnered the most attention in the wake of Deputy Attorney General Monaco’s announcement, compliance consequences—or incentives—can also be applied to prospective incentive compensation, such as future merit bonuses or equity award grants, or compensation paid on an extended schedule, including equity awards subject to future vesting or performance metrics. Compliance consequences may also reach compensation paid after termination or retirement—e.g., deferred compensation, and severance payments and benefits. The Pilot Program memorandum specifies that DOJ may impose, in a criminal resolution, a mandate to prohibit “bonuses” for employees who do not satisfy compliance requirements, but it does not discuss other forms of negative impacts on prospective incentive compensation.

The ability to stop payout of compensation, or to recover it after it has been paid, varies based on jurisdiction and the structure of the compensation. Practically, recovering compensation that has already been paid out is generally more difficult than withholding compensation still in a company's account. Clawing back disbursed funds may require litigation, which could require publicizing the compliance violations that led the company to pursue such action.

Insights From Enforcement Resolutions

What Might a Compensation Policy That Promotes Compliance Look Like?

DOJ's new guidance offers helpful insights into the types of compensation structures that DOJ wants to incentivize. The revised ECCP suggests that prosecutors consider, for example, what role the compliance function has in designing financial incentives for senior employees and whether companies reward employees who demonstrate "ethical leadership." But the Pilot Program and the ECCP offer few details on how such compensation schemes may operate in practice.

Fortunately, similar policies imposed by government agencies in the context of enforcement actions illustrate ways that companies could choose to incorporate compliance incentives and disincentives into compensation. The relevant provisions dictated by these resolutions generally fall into two categories: withholding of future incentive compensation because of a policy or legal violation, and recoupment of previously paid incentive compensation by a company after a prior policy or legal violation is discovered—i.e., an archetypal "clawback."

The agreements between companies and agencies suggest potential approaches for several of the basic questions: the "who" (which employees may be subject to compensation consequences), "what" (the type of compensation at risk), "when" (the period subject to compensation consequences), and "why" (the triggers for compensation consequences).

Corporate Integrity Agreements With HHS-OIG

[Corporate Integrity Agreements](#) (CIAs) may suggest one model for compliance-based compensation consequences. CIAs are contractual arrangements executed between the Department of Health and Human Services, Office of Inspector General (HHS-OIG) and health care providers, suppliers, and other entities as part of resolving investigations arising under various civil false claims statutes, such as the False Claims Act. Dating back to at least 2012, some CIAs have included obligations for companies to implement "financial recoupment programs" and other restrictions on incentive compensation.

Some CIAs have required companies to develop mechanisms to allow the company to take action related to employees' incentive compensation based on violations of law or policy. These policies, which in certain cases have leveraged a company's pre-existing compensation guidelines, generally apply to incentive compensation not yet paid. They are designed to promote compliance among, for example, sales personnel whose compensation is incentive-based and who might otherwise profit from non-compliant sales techniques. There are similarities between these obligations and the new compliance provisions that the Pilot Program aims to impose.

CIA obligations also have included financial recoupment programs, which are typically focused on executives in certain functions most relevant to the purpose of the CIA. In general, these financial recoupment programs put at risk of forfeiture and recoupment—i.e., clawback—an amount equivalent to annual performance pay—including cash and equity awards, as defined in the CIA—for a specified lookback period—often three years—if the executives or their subordinates are found to have engaged in "significant misconduct."

"Significant misconduct" is defined in many of these CIAs to mean a significant violation of laws, regulations, or company policy that, if discovered prior to payment, would have made the executive or their subordinates ineligible for the annual performance pay—including cash bonuses and equity awards. Recoupment may be triggered based on the misconduct of subordinate employees if the misconduct was not an isolated occurrence and the executive knew or should have known it was occurring. The inclusion of executives' subordinates in the scope of the recoupment trigger is designed to promote managerial accountability, and this feature is reflected in the clawback component of the Pilot Program.

Where CIAs have included financial recoupment program obligations, they generally have required companies to establish a standardized process for determining whether a triggering event has occurred and the extent to which cash and equity awards will be subject to repayment or forfeiture. This may include establishing a “Recoupment Committee” composed of senior leadership representing compliance, legal, and other functional areas as deemed necessary, such as finance or internal audit.

If the Recoupment Committee decides that past compensation should be forfeited, the CIAs generally specify that the company “shall endeavor” to collect repayment of all or part of any bonus received by the executive for the lookback period “through reasonable and appropriate means . . . to the extent permitted by controlling law of the relevant jurisdiction,” including through litigation against the executive, as may be appropriate.

Compliance Commitments in Money Laundering Resolutions

Separately, DOJ has included requirements for compliance-related compensation adjustments in the Bank Secrecy Act/Anti-Money Laundering (BSA/AML) context. In multiple Deferred Prosecution Agreements (DPAs) and plea agreements with financial institutions, DOJ's Money Laundering and Asset Recovery Section (MLARS) has required, as part of a company's compliance commitments, that the company implement “evaluation criteria related to compliance in its executive review and bonus system so that each [company] executive is evaluated on what the executive has done to ensure that the executive's business or department is in compliance with U.S. laws.” And, “[a] failing score in compliance will make the executive ineligible for any bonus for that year.”

This provision was imposed on Danske Bank in December 2022, after the September 2022 “[Monaco Memo](#)” was released, as part of the bank's \$2 billion [plea agreement](#) with MLARS and the US Attorney's Office for the Southern District of New York. In Deputy Attorney General Monaco's March 2023 announcement, she heralded the Danske resolution and its compliance-based bonus requirement as an example of DOJ's new approach.

But the Danske Bank plea is not the first time DOJ has required companies to implement compensation consequences for compliance failures. Similar provisions have been used in BSA/AML resolutions dating back to at least 2012, for example in DPAs with [MoneyGram](#) in 2012 and [Western Union](#) in 2017, although the provision is not included in most BSA/AML resolutions.

Notably present in the DPAs for MoneyGram and Western Union, and absent from the more recent plea agreement for Danske Bank, is a further provision requiring each company to “include in its new executive review and bonus system a provision that allows the Company to ‘claw back’ bonuses for executives for conduct . . . that is later determined to have contributed to future compliance failures, subject to applicable law.”

The MoneyGram and Western Union clawback mandates represent a different approach from the one DOJ has now adopted in the Pilot Program, which encourages—but does not require—companies to seek recovery of prior compensation from employees who engaged in wrongdoing and the supervisors who knew or should have known of the misconduct. Indeed, the Pilot Program rewards good faith efforts to recoup compensation, even if they are unsuccessful. The choice to make clawbacks optional may indicate that DOJ appreciates the challenges inherent in clawback litigation.

The commitments to impose compliance metrics for bonus eligibility in these criminal resolutions are targeted at company executives. The Pilot Program does not limit its scope to company leadership, although as a practical matter rank-and-file employees in many industries are generally less dependent on—and so less influenced by—incentive compensation. Given DOJ's continued emphasis on bonuses and managerial accountability, companies may wish to begin their assessments with an evaluation of executive compensation programs.

Other Considerations

The integration of compliance considerations into compensation arrangements is a multi-disciplinary endeavor. In addition to the considerations and models discussed above, companies may also need to take into account:

- Privacy concerns—e.g., whether local law allows the sharing of personally identifiable information from an investigation for employment-related purposes.
- Substantive employment law—e.g., the need to negotiate policy changes with employee representatives, such as a works council.
- Securities law—e.g., how a clawback policy and clawback efforts covering executives may need to be disclosed to investors and the public.
- Tax implications—e.g., what tax and reporting obligations will apply to the company and the individual.

Moreover, as envisioned by the Monaco Memo and the updated ECCP, compliance incentives for employees go beyond the clawback of incentive compensation after it is paid. The Deputy Attorney General encouraged a more holistic integration of compliance into the HR function, including the use of “compliance benchmarks,” and affirmative incentives that reward “compliance-promoting behavior” in performance reviews.

Although companies may have a concern that rewarding compliance may undermine the fact that compliance is a baseline expectation of employees, the Monaco Memo and the revised ECCP should be interpreted as encouraging companies to increase emphasis on compliance in company culture and employment decisions. Some companies may choose, for example, to reward employees who go above and beyond in enforcing compliance rules, add a compliance metric to performance evaluations, or require employees to set compliance goals.

Just a [month after](#) the Monaco Memo, and prior to the release of the Pilot Program, the Securities and Exchange Commission (SEC) [adopted a rule](#) that requires listed companies to adopt clawback policies to recover certain incentive compensation following an accounting restatement, regardless of whether the employee in question was involved or at fault. Although this policy shows the government's willingness to require modifications to employment agreements, it serves fundamentally different goals from the Pilot Program and the ECCP. Companies subject to these SEC rules will need to be mindful of the differences.

Five Steps Companies Should Consider Now

After the announcement of the Criminal Division's Pilot Program and the revised ECCP, the baton has been passed to the private sector. Companies should consider steps to proactively assess their current policies and lay the groundwork to take compensation action in the future, such as in the event of significant misconduct by an executive or other employee. Any clawback policy should include at least the basic “who, what, when, and why” considerations.

In examining whether and how to integrate compliance criteria into compensation decisions, here are five key steps to consider:

- **Evaluate whether current incentive compensation agreements and equity awards allow for compliance-related clawbacks, assuming the company wants to take this step in appropriate cases.** Companies with clawback policies generally must obtain agreements from employees memorializing their understanding that their compensation could be affected by policy violations, or otherwise include the company's ability to clawback in the terms and conditions applicable to the compensation. Some companies may already have such agreements or documentation in place, whether or not the clawback policy is intended to address compliance-related concerns.

- **Assess the authority and process to make and implement compensation decisions quickly.** A company's compliance, audit, or legal functions often handle the review of conduct or facts giving rise to compensation consequences. However, compensation consequences are generally enforced by a company's compensation committee for senior executives, or by another function, such as HR, for other employees. Once a finding is made that an executive's or employee's behavior should affect his or her compensation, the compensation committee or other decision maker should be prepared to execute an established process to effectuate that decision. That process should take into account the company's policy, local law considerations, tax implications and shareholder disclosure requirements.
- **Establish clear metrics for evaluating executives' and employees' contributions to company compliance, and communicate them to employees.** As indicated by prior resolutions and the new guidance, DOJ may expect companies to evaluate whether executives have done enough to promote compliance in their business units. Companies that already have mature compliance metrics for business units may wish to consider how to apply them to executives in compensation decisions, or to otherwise establish a process for evaluating executives along a compliance dimension. These metrics should be clearly incorporated in policies and trainings to provide notice.
- **Consider ways to incorporate compliance department input into the evaluation of promotion decisions and bonuses or other merit-based pay awards.** Companies may choose to incorporate a standard compliance check before offering promotions or bonuses for employees to avoid rewarding noncompliant business practices.
- **Establish a system for documenting and tracking compliance-related compensation decisions.** Companies should establish a process for documenting promotions or awards provided or denied, compensation recouped or deferred compensation cancelled, or other compensation decisions impacted, in each case as a result of compliance and ethics considerations.

Conclusion

Although DOJ's expectations will likely be clarified further in future resolutions, companies should not put off the consideration of these issues. With that said, for many companies, the shift towards the implementation of clawback policies and other compliance-related consequences for compensation is likely to be gradual, and DOJ will likely recognize that companies and their compliance officers do not have magic wands.

Monaco hopes to inspire a "culture of compliance," and compensation will be an important tool.

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