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SEC's final pay-versus-performance disclosure rules arrive for 2023 proxy season

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The SEC recently adopted long-awaited pay-versus-performance executive compensation disclosure rules that will be effective for the 2023 proxy season.



What's the Impact?

- / The new rules require certain reporting companies to provide specific disclosures concerning the relationship between executive pay and the company's financial performance
- / The new rules will be effective for the 2023 proxy season
- / Companies should review the expanded disclosure requirements now and consult with counsel, compensation committees, external advisers, and internal teams responsible for preparing proxy statement disclosures to ensure compliance

On August 25, 2022, the Securities and Exchange Commission (SEC) [adopted long-awaited pay-versus-performance executive compensation disclosure rules](#) (PVP Rules) mandated over a decade ago by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). The new PVP Rules require reporting companies, other than emerging growth companies, registered investment companies, and foreign private issuers, to provide certain prescribed

disclosures concerning the relationship between compensation “actually paid” to their named executive officers and their and their respective peer group’s “financial performance” in proxy or information statements in which executive compensation disclosure is required under Item 402 of Regulation S-K. Smaller reporting companies are subject to scaled disclosure requirements under the PVP Rules.

The PVP Rules will be effective thirty (30) days after publication in the *Federal Register*. Companies must begin to comply with the expanded disclosure requirements in proxy and information statements that are required to include executive compensation disclosure for fiscal years ending on or after December 16, 2022. For a calendar year reporting company, this means the new pay- versus-performance disclosures will be required in the company’s proxy statement for the 2023 annual meeting of shareholders.

The SEC first proposed amendments to Regulation S-K in 2015 to implement the Dodd-Frank pay-versus-performance disclosure mandate and reopened the comment period on that proposal in January 2022. In support of the PVP Rules, which impose uniform definitions and methodologies for determining compensation “actually paid” and “financial performance,” standardize the format and presentation for reporting such data, and require identification of additional performance-related metrics the company considers important for linking executive compensation to company performance, [SEC Chair Gary Gensler indicated](#) that the final rules “allow companies to describe the performance measures it deems most important when determining what it pays executives” and “will help investors receive the consistent, comparable, and decision-useful information they need to evaluate executive compensation policies.” Dissenting SEC Commissioner Hester Pierce, however, [criticized the rules](#) as “elicit[ing] costly, complicated disclosure of questionable utility.”

What additional disclosures will be required?

As more fully discussed below, the PVP Rules require companies to provide a table disclosing specified executive compensation and financial performance measures for each of their five (5) most recently completed fiscal years, subject to a transition period. Companies will be required to report in the table their total shareholder return (TSR), the TSR of their peer group, net income, and an additional financial performance measure chosen by the company (Company-Selected Measure). Based on this information, companies also will be required to clearly describe (graphically and/or narratively) both the relationships between the executive compensation actually paid and each of the performance measures and the relationship between the company’s TSR and the TSR of the companies in its peer group. Additionally, each company will be required to provide an unranked list (Tabular List) of the three (3) to seven (7) financial performance measures that it considers the company’s most important performance measures for purposes of linking executive compensation actually paid to company performance during the last completed fiscal year. The Company-Selected Measure will be the financial measure included in the company’s Tabular List which the company believes represents the most important performance measure (other than those otherwise required to be disclosed in the table) used by the company to link compensation actually paid to the company’s named executive officers, for the most recently completed fiscal year, to company performance.

More specifically, new Item 402(v) of Regulation S-K requires the following disclosures in any proxy and information statements for which executive compensation disclosure is required:

Pay Versus Performance Table

Required disclosures will include a new Pay Versus Performance table, which must include, for each of the last five (5) completed fiscal years (three (3) years in the case of a smaller reporting company), the following columns presented in the following order:

- / The total compensation of the company's principal executive officer (PEO) (generally, the CEO) as reported in the Summary Compensation Table (SCT)
- / The compensation "actually paid" to the PEO, with footnote disclosure detailing each adjustment made to total compensation as reported in the SCT for purposes of calculating the amount "actually paid"
- / The average (mean) total compensation of the company's named executive officers other than the PEO, based on total compensation amounts reported in the SCT
- / The average compensation "actually paid" to the company's named executive officers other than the PEO, with footnote disclosure detailing each adjustment made to total compensation as reported in the SCT for purposes of calculating the amount "actually paid"
- / The company's cumulative TSR, using substantially the same definition of and methodology of calculating total shareholder return set forth in Item 201(e) of Regulation S-K that is used for purposes of preparing the stock performance graph required to be included in the company's annual report
- / For companies other than smaller reporting companies, the weighted average cumulative TSR of the company's peer group, using either (1) the same peer group presented in the company's annual report stock performance graph or (2) the peer group reported in the Compensation Discussion and Analysis (CD&A) for purposes of evaluating executive compensation, including the identity of the issuers comprising the group if the selected peer group is not a published line of business or industry index
- / The company's net income, calculated in accordance with U.S. Generally Accepted Accounting Principles (U.S. GAAP)
- / For companies other than smaller reporting companies, the Company-Selected Measure that the company believes represents the most important financial performance measure (other than those otherwise required to be disclosed in the table) is used by the company to link executive compensation actually paid during the most recently completed fiscal year to company performance

Companies are permitted to supplement the required tabular disclosure, so long as any additional disclosure is clearly identified as supplemental, not misleading, and not presented with greater prominence than the required disclosure.

Companies will be required to separately tag each value disclosed in the table, block-text tag the footnote and relationship disclosure, and tag specific data points within the footnote disclosures, in each case, in inline XBRL (iXBRL). Smaller reporting companies will not be required to provide iXBRL formatting of the disclosures until the third filing in which pay-versus-performance disclosure is required.

For reference purposes, the form of the Pay Versus Performance table provided in the SEC's PVP Rules adopting release is shown below:

Year	Summary Compensation Table Total for PEO	Compensation Actually Paid to PEO	Average Summary Compensation Table Total for Non-PEO NEOs	Average Compensation Actually Paid to Non-PEO NEOs	Value of Initial Fixed \$100 Investment Based On:		Net Income	[Company-Selected Measure]*
					Total Shareholder Return	Peer Group Total Shareholder Return*		
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
Y1								
Y2								
Y3								
Y4*								
Y5*								

Asterisked items indicate portions of the disclosure requirements from which smaller reporting companies are exempt.

Clear description of relationship between pay and performance

The PVP Rules will also require, following the table described above, narrative and/or graphical disclosure (at the company's election) that will augment the information presented in the table and must clearly describe, for each year covered, the relationship between each of:

- / Executive compensation "actually paid" and the cumulative TSR of the company
- / The cumulative TSR of the company and the TSR of the company's peer group
- / Executive compensation "actually paid" and net income
- / Executive compensation "actually paid" and the Company-Selected Measure
- / If applicable, executive compensation "actually paid" and any supplemental performance measures voluntarily provided by the company

Tabular List

Required disclosures will also include the Tabular List, which must provide (but not rank) the three (3) to seven (7) "most important" financial performance measures (among them, the

Company-Selected Measure) used by the company to link executive compensation actually paid during the most recently completed fiscal year to company performance.

If a company considers fewer than three (3) financial performance measures when it links executive compensation actually paid during the fiscal year to company performance, it will be required to disclose only the number of measures it actually considers

For purposes of the PVP Rules, “financial performance measures” means measures that are determined and presented in accordance with the accounting principles used in preparing the company’s financial statements, any measures that are derived wholly or in part from such measures, and stock price and total shareholder return. A financial performance measure need not be presented within the company’s financial statements or otherwise included in a filing with the SEC to be included in the Tabular List or be the Company-Selected Measure.

Companies may also include supplemental non-financial performance measures in the Tabular List, but only if such measures are included in the company’s three (3) to seven (7) most important performance measures and the company has disclosed at least three (3) (or fewer, if the company only uses fewer) most important financial performance measures.

For presentation purposes, companies may choose to provide the Tabular List as a single list applicable to all named executive officers, as two lists, one applicable to the CEO and the other applicable to the remaining named executive officers, or as separate lists for the CEO and each named executive officer. Each list, however, must include at least three and no more than seven financial performance measures, as discussed above.

Which executives must be included?

The required disclosures will cover the named executive officers for whom disclosure is currently required in the SCT and other executive compensation disclosures, with compensation information presented separately for each person who served as CEO in a covered year and as an average for the remaining named executive officers. Although compensation information for named executive officers other than the CEO will be presented on an aggregate basis, companies will be required to identify, in footnote disclosure, the individual named executive officers whose compensation amounts are included in the average for each year presented in the table.

How will compensation “actually paid” be calculated?

Compensation “actually paid” to a named executive officer will be equal to the individual’s total compensation as reported in the SCT, adjusted for amounts included specifically attributable to pension benefits and equity award valuations. Specifically, reported total compensation will be modified to:

- / Deduct the aggregate change, if any, in the actuarial present value of accumulated benefits under defined benefit and actuarial pension plans
- / Add back the aggregate of (1) actuarially determined service cost for services rendered in the

applicable fiscal year and (2) the entire cost of benefits granted in a plan amendment or initiation during the covered fiscal year that are attributed by the benefit formula to services rendered in prior period, in each case calculated in accordance with U.S. GAAP

/ Deduct the reported grant date fair values of equity awards

/ Add or subtract, as applicable, the following in respect of equity awards:

- The year-end fair value of any awards granted in the covered fiscal year that are outstanding and unvested as of the end of the covered fiscal year
- The amount of year-over-year change as of the end of the covered fiscal year in fair value of any awards granted in prior years that are outstanding and unvested as of the end of the covered fiscal year
- For awards that are granted and vest in the same covered fiscal year, the fair value as of the vesting date
- For awards granted in prior years that vest in the covered fiscal year, the amount equal to the change in fair value from the end of the prior fiscal year to the vesting date
- For awards granted in prior years that are determined to fail to meet the applicable vesting conditions during the covered fiscal year, a deduction for the amount equal to the fair value at the end of the prior fiscal year
- The dollar value of any dividends or other earnings paid on stock or option awards in the covered fiscal year prior to the vesting date that is not otherwise reflected in the fair value of such award or included in any other component of total compensation for the covered fiscal year

Any valuation assumptions used in the calculation of the fair value adjustments described above that differ materially from the valuation assumptions disclosed at the time of grant must be disclosed in a footnote.

What requirements will apply to non-GAAP financial measures included in the required disclosures?

For many companies, the Company-Selected Measure and other financial performance measures included in the disclosures required under the PVP Rules may be non-GAAP financial measures. Consistent with the SEC's treatment of non-GAAP financial measures discussed in the CD&A as performance targets for incentive compensation plans, disclosure of a non-GAAP financial measure under the PVP Rules will not be subject to the requirements of Regulation G and Item 10(e) of Regulation S-K. However, the company must provide disclosure as to how the measure is calculated from the company's audited financial statements.

Are there any specific requirements for the placement of the required disclosures?

Companies will have flexibility regarding the placement of the required disclosures in the proxy or information statement. The disclosures need not be included in the CD&A, and companies can choose where in the proxy or information statement to provide the expanded pay-versus-performance disclosures mandated by the PVP Rules.

When will these expanded pay-versus-performance disclosures be required?

The additional disclosures will be required in any proxy and information statements for fiscal years ending on or after December 16, 2022, in which executive compensation disclosure under Item 402 of Regulation S-K is required (i.e., proxy and information statements involving shareholder action to be taken with regard to the election of directors or compensation plans or arrangements in which the company's directors or executive officers will participate). Unlike other disclosures required by Item 402 of Regulation S-K, the pay-versus-performance disclosures required by Item 402(v) will not be required in a company's Form 10-K or registration statements and will not be deemed to be incorporated by reference into the company's periodic reports or registration statements.

Companies will be afforded a transition period for full compliance with the initial proxy or information statement to include three (3) years of disclosure. An additional year of disclosure must be included in each of the next two (2) years. For smaller reporting companies, the initial proxy or information statement must include two (2) years of disclosure, and an additional year of disclosure will be required in the following year. Additionally, as noted above, smaller reporting companies will not be required to provide iXBRL formatting of the disclosures until the third filing in which pay-versus-performance disclosure is required.

What entities will be required to make this disclosure?

The PVP Rules will apply to all reporting companies other than emerging growth companies, foreign private issuers, and registered investment companies. Smaller reporting companies will be required to provide the proposed disclosures, subject to the scaled reporting requirements and an extended transition period for implementation noted above.

What should I be doing now to prepare?

Companies whose fiscal year ends on or after December 16, 2022, should begin now to prepare to include the required disclosures in their 2023 proxy statements. While much of the numerical information required in the Pay Versus Performance table and related disclosures is either included elsewhere in the company's disclosures under existing rules or can be derived from currently required disclosures, gathering data and calculating certain information, such as the information needed to calculate compensation "actually paid," may be burdensome and time-consuming. Additionally, it may be challenging to provide useful and informative descriptive disclosure about the relationship between compensation "actually paid" and the required financial performance measures, as well as the comparison of the company's TSR to that of its peer group. This may be especially important where, for example, the company's pay practices focus on performance factors not readily translated into or comparable to short-term changes in stock price or where a company's capital deployment strategy differs materially from that of other members of its peer group.

Companies will want to review the requirements of new Item 402(v) of Regulation S-K and consult early with their counsel, compensation committees, internal teams involved in preparing

proxy statement disclosures, and external proxy and compensation consultants, giving careful consideration to the following:

- / Selection of the Company-Selected Measure and other financial (and non-financial, if any) measures to be included in the company's Pay Versus Performance Table and Tabular List
- / Calculation of compensation "actually paid" and, specifically, the required fair value adjustments to total compensation as reported in the SCT
- / Identification of the peer group to be used for TSR comparison purposes and related disclosure implications
- / The use of graphs and/or narrative disclosures to best present to shareholders the required descriptions of the relationships between compensation "actually paid" to the company's named executive officers and financial performance
- / The desirability of including any supplemental disclosures to augment the required disclosures
- / Any necessary changes to the company's disclosure controls and procedures

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