

Additional SEC Guidance on Pay versus Performance Disclosure for 2023 Proxy Season

by Cam C. Hoang

Most reporting companies are required to provide pay versus performance disclosure in their 2023 proxy statements as a result of rules finalized by the Securities and Exchange Commission in September 2022. The disclosure consists of three principal components: (i) a pay versus performance table presenting CEO compensation and an average of other NEO compensation alongside certain financial performance measures, (ii) a description of the relationships between each of the financial performance measures and executive compensation, and between the company's TSR and peer group TSR, and (iii) a tabular list of the most important performance measures. Last week, the SEC released additional guidance, in the form of 13 compliance and disclosure interpretations (C&DIs), which address the following topics:

- Incorporation by Reference (128D.01): There is no incorporation by reference of pay versus performance disclosure into 10-K annual reports, registration statements or other filings, unless otherwise specified by the reporting company.
- Adjustments for Compensation Actually Paid – Pre-NEO Awards (128D.02): Change in value during tenure as an NEO, of equity awards granted prior to appointment as an NEO, should be included in “compensation actually paid.”
- Adjustments for Compensation Actually Paid – Number of Years Footnoted (128D.03): For the first pay versus performance table, footnote amounts deducted and added to arrive at “compensation actually paid” for each of the fiscal years presented, and for subsequent tables, generally present only the most recent fiscal year unless material to an understanding of the table and relationships for the most recent fiscal year.
- Adjustments for Compensation Actually Paid – Level of Detail on Adjustments (128D.04): Each of the amounts deducted and added to arrive at “compensation actually paid,” pursuant to Items 402(v)(2)(iii)(B)(1)(i) – (ii) and Items 402(v)(2)(iii)(C)(1)(i) – (vi), should be footnoted, not just aggregated adjustments.
- Peer Group TSR – Permissible Compensation Peer Groups (128D.05): Peer group TSR may be based on a peer group disclosed in the CD&A as a peer group actually used to help determine executive pay, even if the peer group is not technically used for “benchmarking,” as that term is defined in the C&DIs to mean using compensation data about other companies as a reference point on which to base a compensation decision. But keep in mind that reporting companies have the option of basing TSR

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on a compensation peer group or on a market or industry index as permitted for the stock performance graph under Item 201(e) of Regulation S-K.

- **Measurement Point for TSR (128D.06):** The cumulative TSR measurement period begins on the registration date for reporting companies that register a class of securities during the earliest fiscal year included in the pay versus performance table.
- **Peer Group TSR – Use the Peer Group for that Year (128D.07):** If a compensation peer group is used to calculate TSR, use the compensation peer group for that fiscal year, not the peer group from the most recent fiscal year in the pay versus performance table.
- **Net Income (128D.08):** Present net income in the pay versus performance table as it is disclosed in audited GAAP financial statements.
- **Company Selected Measure (or CSM) – Derivatives of Required Measures Can Be CSMs (128D.09):** CSM can be any financial performance measure that differs from the measures otherwise required to be disclosed in the pay versus performance table, including a measure that is derived from such measures, such as such as earnings per share, gross profit, income or loss from continuing operations, or relative total shareholder return.
- **Company Selected Measure – Stock Price as a CSM (128D.10):** Stock price cannot be a CSM if the reporting company does not use it to link compensation actually paid to company performance. If the only impact of a change in stock price is a change in value of awards, that is not a sufficient link. However, if, for example, the stock price is a market condition applicable to an incentive plan award, or is used to determine the size of a bonus pool, it may be included as a CSM.
- **Company Selected Measure – Multi-Year CSMs (128D.11):** The CSM must be the most important financial performance measure used to link pay to performance for the most recently completed fiscal year, and not for a multi-year period.
- **Tabular List of Most Important Measures (128D.12):** Where financial performance measures are only used to determine the size of a bonus pool, but not the size of individual awards, the reporting company may not omit the tabular list of the most important performance measures.
- **Relationships – Aggregating CEO Compensation (128D.13):** Where there were multiple CEOs in a fiscal year, aggregating their compensation for purposes of narrative, graphical or combined comparison between “compensation actually paid” and TSR, net income and the CSM is permitted to the extent that it is not misleading to investors.

As a reminder, reporting companies other than smaller reporting companies will be required to provide the pay versus performance information for three years in the first proxy or information statement, adding another year of disclosure in each of the two subsequent annual proxy filings that require this disclosure. Smaller reporting companies will initially be required to provide the information for two years, adding an additional year of disclosure in the subsequent annual proxy or information statement that requires this disclosure.