

SEC Adopts Mandatory Pay-versus-Performance Disclosure for 2023 Proxy Statements

by Cam C. Hoang

The Securities and Exchange Commission (the “SEC”) has adopted final rules requiring additional disclosures on the relationship between executive compensation and financial performance. SEC disclosure counsel should establish expectations and a process now for collecting, calculating and analyzing the necessary information. Reporting companies must begin to comply with these disclosure requirements in proxy and information statements for fiscal years ending on or after December 16, 2022.

Which companies are subject to the rules?

New Item 402(v) of Regulation S-K will apply to all reporting companies, except foreign private issuers, registered investment companies, and Emerging Growth Companies. Smaller Reporting Companies (“SRCs”) will be permitted to provide scaled disclosures. The rules are intended to help investors better assess an executive compensation program when making voting decisions, for example when exercising their rights to cast advisory votes on executive compensation or when electing directors.

Where may the new disclosure be located?

The final rules provide reporting companies with flexibility in determining where in the proxy or information statement to provide the required disclosure. The SEC believed that mandating disclosure in the CD&A may cause confusion by suggesting that the company considered the pay-versus-performance relationship in its compensation decisions, which may or may not be the case. The information required by Item 402(v) will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, including Part III of Form 10-K, except to the extent that the company specifically incorporates it by reference.

What disclosure is required?

1. Pay-versus-Performance Table

Related People

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Related Capabilities

- Corporate Governance & Compliance
- Executive Compensation

Reporting companies must provide a table disclosing specified executive compensation and financial performance measures for their five most recently completed fiscal years, or three for SRCs. We have provided a template of the table [here](#), with explanatory footnotes as to the information companies must prepare to populate the table. Companies may supplement the tabular disclosure, for example with graphs, so long as any additional disclosure is clearly identified as supplemental, not misleading, and not presented with greater prominence than the required disclosure.

Registrants will be required to include in the table, for the principal executive officer (“PEO”) and, as an average, for the other named executive officers (“NEOs”):

- total compensation as presented in the Summary Compensation Table and
- a measure reflecting “executive compensation actually paid,” as prescribed in Item 402(v), with adjustments to the pension values and equity awards disclosed in the Summary Compensation Table and with footnote disclosure of the amounts that are deducted from, and added to, the Summary Compensation Table amounts.
 - Financial reporting personnel should be alerted that in order to comply with this item, companies will need to calculate the fair value, and changes in fair value, of outstanding awards as of the end of each fiscal year and as of each vesting date, and they will need to provide footnotes describing any material changes in underlying assumptions.
 - SRCs will not be required to disclose amounts related to pensions for purposes of disclosing executive compensation actually paid.

The final rules do not require aggregating the compensation of PEOs in years when a company had multiple PEOs. Instead, the final rules require that, in those years, registrants include separate Summary Compensation Table total compensation and executive compensation actually paid columns for each PEO.

The financial performance measures to be included in the table are:

- Total shareholder return (“TSR”) for the reporting company, calculated on the same cumulative basis as is used in Item 201(e) of Regulation S-K, measured from the market close on the last trading day before the company’s earliest fiscal year in the table through and including the end of the fiscal year for which TSR is being calculated, and based on a fixed investment of one hundred dollars at the measurement point;
- TSR for the reporting company’s peer group, weighted according to the respective issuers’ stock market capitalization at the beginning of each period for which a return is indicated, using either the same peer group used for purposes of Item 201(e) of Regulation S-K or a peer group used in the CD&A for purposes of disclosing registrants’ compensation benchmarking practices; if the peer group is not a published industry or line-of-business index, the identity of the issuers composing the group must be disclosed in a footnote or incorporated by reference from another filing;
- The reporting company’s net income; and
- A financial performance measure chosen by the reporting company and specific to the company (the “Company-Selected Measure”) that, in its assessment, represents the most important financial performance measure the company uses to link compensation actually paid to the NEOs to company performance for the most recently completed fiscal year.

As the Company-Selected Measure must be a measure included in the tabular list of performance measures described below, the determination of “most important” that registrants must use for selecting Company-Selected Measures is the same as the determination they must use for selecting required measures for the tabular list. As a result, the SEC acknowledges that the Company-Selected Measure could change from one filing to the next.

SRCs are exempted from disclosing peer group TSR and the Company Selected Financial Measure.

2. Clear Description of Relationships

Item 402(v) also will require a reporting company to provide a clear description of:

- the relationships between each of the financial performance measures included in the table and the executive compensation actually paid to its PEO and, on average, to its other NEOs over the company’s five most recently completed fiscal years; and
- the relationship between the company’s TSR and its peer group TSR.

Reporting companies have flexibility as to the format in which to present the descriptions of these relationships, whether graphical, narrative, or a combination of the two.

- For example, a graph may provide executive compensation actually paid and change in the financial performance measure(s) (TSR, net income, or Company-Selected Measure) on parallel axes and plotting compensation and such measure(s) over the required time period.
- Alternatively, the required relationship disclosure could include narrative or tabular disclosure showing the percentage change over each year of the required time period in both executive compensation actually paid and the financial performance measure(s) together with a brief discussion of how those changes are related.

Reporting companies will also have the flexibility to decide whether to group any of these relationship disclosures together when presenting their clear description disclosure, but any combined description of multiple relationships must be “clear.”

SRCs will only be required to present such clear descriptions with respect to the measures they are required to include in the table and for their three, rather than five, most recently completed fiscal years.

3. Tabular List of Most Important Performance Measures

Reporting companies other than SRCs also will be required to provide an unranked, tabular list of the three to seven most important financial performance measures used to link executive compensation actually paid to its NEOs during the last fiscal year to company performance.

- There may one list for all NEOs, one for the PEO and one for the remaining NEOs, or separate lists for each NEO.
- If fewer than three financial performance measures were used for the most recently

completed fiscal year, the tabular list must include all such measures that were used, if any.

- Reporting companies are permitted, but not required, to include non-financial measures in the list if they considered such measures to be among their three to seven “most important” measures.

Are performance measures subject to rules regarding disclosure of non-GAAP financial measures?

Because the disclosure is intended, among other things, to supplement the CD&A, the SEC believes it is appropriate to treat non-GAAP financial measures provided under Item 402(v) of Regulation S-K consistently with the existing CD&A provisions. As a result, the final rules specify that disclosure of a measure that is not a financial measure under generally accepted accounting principles will not be subject to Regulation G and Item 10(e) of Regulation S-K; however, disclosure must be provided as to how the number is calculated from the company’s audited financial statements.

May reporting companies keep existing pay-versus-performance disclosure, or supplement the information required by Item 402(v)?

Reporting companies may provide additional pay-versus-performance information beyond what is specifically required by Item 402(v) of Regulation S-K. For example, companies that are already providing voluntary pay-versus-performance disclosures may generally continue to provide such disclosures in their present format, or could include disclosure of long-term performance metrics measured over periods longer than a single fiscal year. Companies will be permitted to include additional compensation and performance measures, or additional years of data, in the newly required table. Any supplemental measures of compensation or financial performance and other supplemental disclosures provided by companies must be clearly identified as supplemental, not misleading, and not presented with greater prominence than the required disclosure.

Must the disclosure be tagged using Inline XBRL?

Reporting companies will be required to use Inline XBRL to tag their pay versus performance disclosure. An SRC will only be required to provide the required Inline XBRL data beginning in the third filing in which it provides pay versus performance disclosure, instead of the first.

How will disclosure be phased in?

Reporting companies other than SRCs will be required to provide the 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. SRCs 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.

