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Securities Law ADVISORY ■

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SEC Adopts Final Pay Versus Performance Disclosure Rules

On August 25, 2022, the Securities and Exchange Commission (SEC) adopted final pay versus performance disclosure rules that will require companies to disclose in their annual proxy statements information reflecting the relationship between executive compensation actually paid by a company and the company's financial performance.

The new rules implement a requirement mandated by the Dodd–Frank Wall Street Reform and Consumer Protection Act. The SEC proposed pay versus performance disclosure rules in 2015 and reopened the comment period on the proposal in January 2022.

The final rules require companies to include in any proxy or information statement for which disclosure under Item 402 of Regulation S-K is required tabular and narrative disclosure of specified executive compensation and financial performance measures for the companies' five most recently completed fiscal years.[1]

All reporting companies (other than foreign private issuers, registered investment companies, and emerging growth companies) must comply with the new disclosure requirements in proxy and information statements that are required to include Item 402 of Regulation S-K disclosure for fiscal years ending on or after December 16, 2022.

This means that, for most reporting companies, the new disclosure will first appear in proxy statements filed for their 2023 stockholder meetings.[2]

This will likely be a significant undertaking for most companies, and they should begin now to gather the necessary information.

Required Tabular Disclosure

The final rules require companies to provide the following information for their five most recently completed fiscal years, in the tabular format provided below:

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[1] Smaller reporting companies are only required to provide information for three years, instead of five.

[2] For the first year of reporting, a registrant may provide the pay versus performance disclosure for the prior three years (instead of five) and may add an additional year in each of the two subsequent annual filings that require this disclosure. Smaller reporting companies may provide two years for the first year of reporting and may add an additional year in the subsequent annual filing.

- The compensation disclosed for its principal executive officer (PEO) and the average compensation disclosed for its other named executive officers (NEOs), in each case as calculated and disclosed in the "Total" column of the Summary Compensation Table.
- The compensation actually paid to its PEO and the average compensation actually paid to its other NEOs, in each case as calculated in accordance with the final rules.
- Its total shareholder return (TSR) and the TSR of companies in the company's peer group, using either the same peer group used for the performance graph required by Item 201(e) of Regulation S-K or a peer group used in the CD&A for disclosing the company's compensation benchmarking practices.
- Its net income, calculated in accordance with U.S. generally accepted accounting principles (GAAP).
- An amount attributable to an additional financial performance measure chosen by the company (the company-selected measure), which may be a non-GAAP metric, that in the company's assessment represents the most important financial performance measure (other than net income or TSR) used by the company to link compensation actually paid to the company's NEOs for the most recently completed fiscal year to company performance. This company-chosen financial performance measure must also be included in a separate tabular list of financial performance measures discussed below.

Pay Versus Performance

Year	Summary Compensation Table Total for PEO ($)	Compensation Actually Paid to PEO ($)	Average Summary Compensation Table Total for Non-PEO Named Executive Officers ($)	Average Compensation Actually Paid to Non-PEO Named Executive Officers ($)	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								

Compensation Actually Paid. The calculation of "compensation actually paid" is complicated and will include pension and equity amounts that differ from those reported in the Summary Compensation Table. For example, the equity values included in the Summary Compensation Table primarily represent the grant date value of the awards for the year of issuance, while the equity values included in the Pay Versus Performance Table will include:

- For all awards granted in the covered fiscal year that remain outstanding and unvested as of the end of such year, the fair value as of the end of the covered fiscal year.
- For all awards granted in a previous fiscal year that remain outstanding and unvested as of the end of the covered fiscal year, the change (positive or negative) in the fair value at the end of the covered fiscal year from the end of the prior fiscal year.
- For all awards granted and vested in the same fiscal year, the fair value as of the vesting date.
- For all awards granted in a previous fiscal year that vest during the covered fiscal year, the change (positive or negative) in the fair value as of the vesting date from the end of the prior fiscal year.

- The dollar value of any dividends or earnings paid on outstanding awards in the covered fiscal year before the vesting date (unless these values are otherwise included in total compensation for the covered fiscal year).
- For awards granted in a prior fiscal year that fail to vest during the covered fiscal year, a reduction equal to the fair value at the end of the prior fiscal year.

Additional Required Disclosure

Relationship Between Pay and Performance. The final rules require companies to use the information in the table to provide a clear description – graphically, narratively, or a combination of the two – of the relationships, across the registrant's five most recently completed fiscal years, between the executive compensation actually paid by the registrant to the PEO and the average of the executive compensation actually paid to the other NEOs included in the Summary Compensation Table, and each of the following:

- The company's cumulative TSR.
- The company's net income.
- The company-selected measure.

Relationship Between TSR and Peer Group TSR. Companies must also include a clear description of the relationship between the company's TSR and the TSR of a peer group chosen by the company over the company's five most recently completed fiscal years.

Tabular List of Most Important Performance Measures. Companies other than smaller reporting companies must include a tabular unranked list of at least three, and up to seven, financial performance measures that in the company's assessment represent the most important financial performance measures used by the company to link compensation actually paid to the company's NEOs for the most recently completed fiscal year to the company's performance. However, if fewer than three financial performance measures were used, then the list must include all the measures that were used, if any. The company-selected measure must be included in this tabular list. Nonfinancial performance measures may be included in this list if the company determines that the measures are among its three to seven most important performance measures and it has disclosed its most important three (or fewer, only if the company uses fewer) financial performance measures.

Supplemental Disclosures

The final rules permit companies to voluntarily provide supplemental measures of compensation or financial performance (in the table or in other disclosure) and other supplemental disclosures so long as any such measure or disclosure is clearly identified as supplemental, not misleading, and not presented with greater prominence than the required disclosure.

Next Steps

Reporting companies should move quickly to gather the information necessary to include the required disclosure in their 2023 proxy statements.

While several of the metrics are relatively easy to calculate and, in some cases, are provided elsewhere in the proxy statement (e.g., total compensation from the Summary Compensation Table), others involve very detailed calculations. Moreover, the information required to be included is not necessarily information that has been regularly collected during a company's proxy statement preparation process and will necessarily involve some additional lead time for companies and their advisers.

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