

SEC Adopts Pay Versus Performance Disclosure Rules Seven Years After Original Proposal

On August 25, 2022, the Securities and Exchange Commission (SEC) adopted final disclosure rules implementing the pay versus performance requirement of the Dodd-Frank Act for most reporting companies. The SEC originally proposed pay versus performance disclosure rules in 2015 and reopened the comment period on the proposal in January of this year.

Overview

The new rules add a new Item 402(v) to Regulation S-K, which will require:

1. specific pay versus performance tabular disclosure;
2. a “clear description (graphically, narratively, or a combination of the two)” of the relationship between each of the financial performance measures included in the tabular disclosure and the actual compensation paid to the company’s principal executive officer (PEO), and on average, the actual compensation paid to the company’s non-PEO named executive officers (NEOs); and
3. a tabular list of three to seven financial performance measures that represent the most important financial performance measures used by the company to link compensation actually paid to the PEO and NEOs to company performance.

The new rules will become effective 30 days following publication in the *Federal Register* and will apply to proxy and information statements for fiscal years ending on or after December 16, 2022; therefore, calendar year-end companies will need to comply with the new rules in their 2023 proxy statements. The new rules will apply to all reporting companies except emerging growth companies, foreign private issuers, and registered investment companies. Smaller reporting companies will be permitted to provide scaled disclosures. Companies will also be required to tag disclosure under the new rules in inline XBRL (except for smaller reporting companies which will have until their third filing under the new rules to provide inline XBRL tagging).

Pay Versus Performance Tabular Disclosure

The new rules will require the following tabular disclosure:

Year (a)	Summary Compensation Table Total for PEO (b)	Compensation Actually Paid to PEO (c)	Average Summary Compensation Table Total for Non-PEO Named Executive Officers (d)	Average Compensation Actually Paid to Non-PEO Named Executive Officers (e)	Value of Initial Fixed \$100 Investment Based on:		Net Income (h)	[Company Selected Measure] (i)
					Total Shareholder Return (f)	Peer Group Total Shareholder Return (g)		
	\$	\$	\$	\$	\$	\$	\$	\$

The table will require information for five fiscal years (column (a)); however, companies will be permitted to disclose the information for three fiscal years in their first proxy or information statement for which they disclose the information, adding another fiscal year of information in each of the two subsequent annual proxy statement filings. Companies that qualify as smaller reporting companies will only be required to disclose information for three fiscal years and will be permitted to disclose the information for two fiscal years in their first proxy or information statement for which they disclose the information.

For columns (b) and (d), the table will require the summary compensation table total for the company’s PEO and the average summary compensation table total for the company’s NEOs. The new rules will then require prescribed adjustments (which adjustments will need to be disclosed in



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footnotes to the table) to those summary compensation table totals for defined benefit and actuarial pension plans and stock and option awards resulting in a compensation actually paid amount that will be disclosed in each of columns (c) and (e).

For column (f), the table will require, for each fiscal year, the cumulative total shareholder return (TSR) of the company, and for column (g), the company's peer group TSR (other than smaller reporting companies which will not be required to provide peer group TSR), in each case, assuming a fixed investment of one hundred dollars. A company will be permitted to use the peer group used by it for purposes of the stock performance graph required by Item 201(e) of Regulation S-K or the peer group the company uses for purposes of its compensation discussion and analysis.

For column (h), the table will require the company's net income for the fiscal year.

For column (i), the table will require the "most important financial performance measure (that is not otherwise required to be disclosed in the table)" used by the company to link compensation actually paid to the CEO and NEOs to the company's performance. Financial performance measure means measures that are determined and presented in accordance with 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 TSR. The company-selected measure does not need to be presented in the company's financial statements or otherwise included in a filing with the SEC in order to be a company-selected measure. Any company selected measure that is not a financial measure under generally accepted accounting principles (GAAP) will not be subject to Regulation G or Item 10(e) of Regulation S-K, and therefore a reconciliation of the non-GAAP measure to the most directly comparable GAAP measure will not be required, but disclosure will need to be provided as to how the number is calculated from the company's audited financial statements. The new rules will also permit a company to include additional measures in the table, provided each additional measure is accompanied by the descriptive disclosure required below. Smaller reporting companies will not be required to include a company-selected measure.

Description of the Relationship Between Pay and Performance

In addition to the tabular disclosure, the new rules will require "a clear description (graphically, narratively, or a combination of the two)" of the relationships between the compensation actually paid to the CEO and the average of the compensation actually paid to the NEOs across the last five fiscal years and (i) the cumulative TSR, (ii) net income and (iii) the company selected measure (and any additional company measures added to the table). The description must also include a comparison of the TSR of the company to the TSR of the company's peer group. Smaller reporting companies will not need to include the company-selected measure or peer group TSR comparison since they will not be required to disclose those measures.

Tabular List of the Most Important Financial Performance Measures

Finally, the new rules will require a tabular list of at least three and up to seven financial performance measures, which represent the company's most important financial performance measures used to link compensation actually paid to the CEO and NEOs for the most recently completed fiscal year, to company performance (with the most important financial performance measure being disclosed as the company selected measure in the summary table described above). The tabular list may be provided as one list (for the CEO and NEOs combined), two separate tabular lists (one for the CEO and one for the NEOs), or as separate lists for the CEO and each NEO. The lists may include non-financial performance measures if the company determines that such measures are among its three to seven most important performance measures. If fewer than three financial performance measures were used by the company to link compensation actually paid, then the tabular list must include all such measures that were used. Smaller reporting companies will not be required to provide the foregoing tabular list.

Location of Disclosure

The new rules do not specify a location in the proxy statement for the new disclosure items, other than the requirement that all of the disclosure must appear with and in the same format as the rest of the disclosure required to be provided under the new rules. Companies may also supplement the required disclosure so long as any additional disclosure is clearly identified as supplemental,

not misleading, and not presented with greater prominence than the required disclosure.

The final rule release is available [here](#), and the SEC's pay versus performance fact sheet is available [here](#).
