September 1, 2022

SEC Adopts Pay-Versus-Performance Disclosure Rule

Requires Disclosure of the Relationship Between Executive Compensation Actually Paid Versus Total Shareholder Return, Net Income and a Company Selected Measure; Effective for the 2023 Proxy Season for Calendar-Year Companies

SUMMARY

On August 25, 2022, by a 3-2 vote, the U.S. Securities and Exchange Commission (the "SEC") adopted amendments to Item 402 of Regulation S-K that require a registrant to disclose the relationship between the executive compensation paid by the registrant and the financial performance of the registrant. A registrant will be required to provide a new table of the following information covering up to the five most recently completed fiscal years: (1) summary compensation table total compensation and compensation "actually" paid to the principal executive officer, (2) average summary compensation table total compensation and average compensation "actually" paid to the other named executive officers, (3) the registrant's cumulative total shareholder return, (4) the total shareholder return of the registrant's peer group, (5) the registrant's net income and (6) a financial performance measure chosen by the registrant.

Additionally, registrants will be required to disclose, in narrative or graphical form, (1) the relationship between executive compensation and the financial performance measures disclosed in the table and (2) the relationship between the registrant's total shareholder return and the peer group total shareholder return. Registrants will also be required to provide an unranked tabular list of three to seven of the most important financial performance measures used to link executive compensation actually paid in the prior fiscal year to company performance.

The new disclosure will be required in proxy statements and information statements in which executive compensation disclosure is required beginning for fiscal years ending on or after December 16, 2022.

Smaller reporting companies will be subject to scaled disclosure requirements, and foreign private issuers, registered investment companies and emerging growth companies are exempt from the new rules.

BACKGROUND

Section 953(a) of the Dodd-Frank Act

In 2010, Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") added a new section 14(i) to the Securities Exchange Act of 1934 that directs the SEC to adopt rules requiring registrants to disclose, in any proxy or consent solicitation material for an annual meeting of shareholders, a clear description of any compensation required to be disclosed by the registrant under Item 402 of Regulation S-K, including information showing the relationship between executive compensation actually paid and the financial performance of the registrant, taking into account any change in the value of shares of stock and dividends of the registrant.

Proposed Rules

On April 29, 2015, the SEC issued proposed rules that would add a new paragraph (v) to Item 402 of Regulation S-K. The SEC reopened the comment period on January 27, 2022, citing significant developments in executive compensation practices as related to company performance.[1] During the reopened comment period, the SEC requested comments on 22 topics related to the proposed rules, including topics related to adding net income and a company-selected measure to the required tabular disclosure under the rule.

FINAL PAY-VERSUS-PERFORMANCE RULES

Under the newly adopted rules,[2] registrants will be required to include the new Item 402(v) disclosure in any proxy or information statements for which disclosure under Item 402 of Regulation S-K is required.

Tabular Disclosure

Item 402(v) will require registrants to disclose, in a table, the following measures for each of the five most recently completed fiscal years:

1. The CEO's total compensation as reported in the Summary Compensation Table.
2. The compensation "actually" paid to the CEO, as described below.
3. The average total compensation of the other named executive officers ("NEOs'") as reported in the Summary Compensation Table.
4. The average compensation actually paid to the other NEOs.
5. The registrant's total shareholder return ("TSR"), calculated on the same cumulative basis as is used in Item 201(e) of Regulation S-K.
6. Peers' TSR, either for 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 compensation benchmark practices.

7. The registrant's net income.

8. An additional financial performance measure selected by the registrant ("Company-Selected Measure"), which represents the most important performance measure used by the registrant to link actual compensation paid during the most recent fiscal year to registrant performance. The Company-Selected Measure is not subject to the general rules regarding the disclosure of non-GAAP financial measures, but the registrant will be required to disclose how the number is calculated from its audited financial statements.

If more than one individual served as CEO during a covered fiscal year, then each will be disclosed separately. A registrant will be required to name each NEO included in the table for each fiscal year in footnotes to the table.

The pay-versus-performance table will be formatted as follows, with the asterisked items indicating portions of the disclosure from which smaller reporting companies are exempt:

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)		
Y1								
Y2								
Y3								
Y4*								
Y5*								

Calculating "Actual" Compensation Paid

Actual compensation paid will equal the total compensation reported in the Summary Compensation Table with adjustments to the value of stock and option awards and the change in pension value.

The value of stock and option awards as reported in the Summary Compensation Table will be replaced with the fair value of equity awards granted during the covered fiscal year, measured at the end of the year (or, for awards that were granted and vested in the same year, as of the vesting date) *plus* the change in fair value of unvested awards granted in prior fiscal years, measured at the end of the covered fiscal year (or, for awards that vested in the covered fiscal year, as of the vesting date) *less* the fair value of awards that were forfeited during the covered fiscal year, measured as of the prior fiscal year-end. This value should also include any dividends or earnings paid on equity awards in the covered fiscal year prior to vesting that are not otherwise included in the total compensation for that year. Fair value must be calculated consistent with the methodology used in the registrant's financial statements under generally accepted accounting principles.

The change in pension value will be replaced with the aggregate of (i) an actuarially determined service cost for services rendered by the executive in the applicable year, which would exclude the portion of the total change in actuarial pension value that results solely from changes in interest rates, an executive's age and other actuarial inputs and assumptions regarding benefits accrued in prior years, and (ii) any prior service cost in connection with a plan amendment (or initiation) during the applicable year.

Registrants will be required to disclose in footnotes to the table any amounts added or deducted from the total compensation reported in the Summary Compensation Table for purposes of calculating actual compensation paid.

Total Shareholder Return

The cumulative TSR disclosed for the registrant and the registrant's peers generally will be calculated in the same manner as required under Item 201(e) of Regulation S-K, measuring the period from the market close on the last trading day before the earliest fiscal year in the table through and including the end of the fiscal year for which cumulative TSR is calculated. The calculation assumes a fixed investment of $100, and weights each component issuer of the peer group according to their respective market capitalizations at the beginning of the period.

If a registrant uses a different peer group from the peer group used in the prior fiscal year for this purpose, the registrant will be required to explain the reason for the change and compare the registrant's cumulative TSR with that of both the newly selected peer group and the peer group from the prior fiscal year.

Additional Disclosure Requirements

Registrants will be required to provide a "clear description," in graphic or narrative form, of the following relationships over the five-year period covered by the table:

- the relationship between the CEO's actual compensation and the remaining NEOs' actual compensation to (1) the registrant's TSR, (2) the registrant's net income and (3) the Company-Selected Measure; and
- the relationship between (1) the registrant's TSR and (2) the TSR of the registrant's peer group.

Additionally, registrants will be required to provide an unranked list of at least three, and not more than seven, of the most important financial performance measures used by the company to link actual compensation paid during the most recent fiscal year to registrant performance. Registrants may include non-financial performance measures on this list if those measures are among the registrant's three to seven most important performance measures, as long as at least three financial performance measures are included. If fewer than three financial performance measures were used by the registrant to link compensation to registrant performance, then all measures that were used must be listed.

Smaller Reporting Company Scaled Disclosures

Smaller reporting companies will be subject to scaled reporting requirements, which will permit the registrant to exclude the peer group TSR, registrant net income and the Company-Selected Measure from the tabular disclosure, and limit the table to the three most recently completed fiscal years. Additionally, smaller reporting companies will not be required to disclose amounts related to pensions for purposes of calculating actual compensation paid or provide an unranked list of the most important financial performance measures.

XBRL Requirement

Registrants 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 Inline XBRL. A smaller reporting company will be required to provide disclosure in XBRL format beginning in the third fiscal year in which it provides pay-versus-performance disclosure.

Transition Periods

Registrants will need to comply with Item 402(v) of Regulation S-K in proxy and information statements that are required to include Item 402 disclosure for fiscal years ending on or after December 16, 2022. The table provided in the first filing in which a registrant provides the disclosure may be limited to three fiscal years (or, for smaller reporting companies, two fiscal years), with an additional fiscal year added in each subsequent annual filing. Disclosure will be required only for years that a registrant was a reporting company pursuant to Section 13(a) or Section 15(d) of the Exchange Act.

Exempted Companies

Consistent with the proposed rules, foreign private issuers, registered investment companies and emerging growth companies are exempt from the new disclosure rules.

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ENDNOTES

[1] For more information, see Sullivan & Cromwell, *SEC Reopens Commend Period for Pay-Versus-Performance Disclosure Rule* (February 2, 2022), *available at* https://www.sullcrom.com/files/upload/sc-publication-SEC-reopens-comment-period-pay-vs-performance.pdf.

[2] Securities Exchange Commission, *Pay Versus Performance* (SEC Release No. 34-95607), *available at* https://www.sec.gov/rules/final/2022/34-95607.pdf.

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