February 2, 2022

SEC Reopens Comment Period for Pay-Versus-Performance Disclosure Rule

Original 2015 Proposal Would Require Disclosure on the Relationship of Executive Compensation Paid and Registrant Financial Performance

SEC Seeks Comment on Original Proposal and Twenty-Two Potential Changes to the Original Proposal

SUMMARY

On January 27, 2022, the U.S. Securities and Exchange Commission (the "SEC") reopened a 30-day comment period (beginning today) on proposed rules requiring registrants to disclose how executive compensation actually paid by a registrant relates to the financial performance of that company.[1] Stakeholders may submit comments both on the original proposed rules and on 22 new questions raised by the SEC. The new questions suggest several potential additional requirements under consideration, including expanding the performance measures to be disclosed in relation to executive compensation.

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 materials for an annual meeting of shareholders the relationship between named executive officer "actual" pay and the financial performance of the registrant, taking into account any alteration in the value of shares of stock and dividends of the registrant.

Proposed Rules

In furtherance of this provision of the Dodd-Frank Act, on April 29, 2015 the SEC issued proposed rules (the "Proposed Rules") that would add a new paragraph (v) to Item 402 of Regulation S-K requiring that registrants disclose the following in a new required table for each of the most recent five years:

- the CEO's total compensation and the average of the other named executive officers' total compensation as reported in the summary compensation table;
- the CEO's "actual" pay (described below) and the average of the other named executive officers' "actual" pay; and
- the registrant's and its peers' annual total shareholder return, using the definition of total shareholder return from Item 201(e) of Regulation S-K (providing for a performance graph to be included in the annual report) and using either the peer group used in the Item 201(e) performance graph or the peer group reported in the compensation discussion and analysis. Smaller reporting companies would not be required to present a peer group total shareholder return.

"Actual" pay would equal the total amount reported in the summary compensation table with two adjustments: (1) equity awards would be considered actually paid on the date of vesting and at fair value on that date, rather than fair value on the grant date as required in the Summary Compensation Table, and (2) change in pension value would be excluded and replaced with an actuarially determined service cost (although this would not be required for smaller reporting companies) so as to 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 previous years.

The registrant would also be required to describe through narrative description and/or graphic presentation the relationship of "actual" pay to its total shareholder return and its total shareholder return to that of its peers. Registrants would be required to tag the disclosure in an interactive data format using XBRL to allow for more rapid comparison across registrants (to be phased in for smaller reporting companies).[2]

The Proposed Rules were included in a release published on May 7, 2015 in the Federal Register. During the original comment period, which ended on July 6, 2015, the SEC received more than 70 comment letters in respect of the Proposed Rules.

In reopening the comment period,[3] the SEC observed that there have been significant developments in executive compensation practices as related to company performance since Section 953(a) of the Dodd-Frank Act was enacted in 2010 and the Proposed Rules were issued in 2015.[4]

TOPICS AND DATA SOLICITED IN THE COMMENT PERIOD

The SEC specifically requested comments on the following 22 areas.

1. **Adding Pre-Tax Net Income and Net Income as Financial Performance Measures**: The SEC is considering whether the disclosure of additional financial performance

measures beyond total shareholder return should be required in the tabular disclosure required by the Proposed Release and discussed in the required description to the tabular disclosure. The SEC requested comment on whether a requirement that pre-tax net income and net income be added to the tabular disclosure would be helpful to investors or whether such addition should be optional.

2. **Alternative Financial Performance Measures**: Instead of pre-tax net income and/or net income, the SEC is considering whether any additional or alternative measures should be required and solicited stakeholder input on what other measures would be most helpful.

3. **Including a Company-Selected Measure**: The SEC is proposing that a third measure, the "Company-Selected Measure," be included in the tabular disclosure and that it be defined as the "measure that in the registrant's assessment represents the most important performance measure (that is not already included in the table) used by the registrant to link compensation actually paid during the fiscal year to company performance."[5] The SEC asked commenters to consider whether such a definition would be sufficiently clear for registrants and whether other requirements should be included for determining and calculating the Company-Selected Measure.

4. **Company-Selected Measure Used in an Incentive Plan**: The SEC is considering, and requested comment on, whether it would be helpful to investors to have the Company-Selected Measure be the most important measure used as a performance condition in the registrant's incentive plan or in determining non-incentive plan compensation.

5. **Defining "Most Important"**: The SEC solicited comments in respect of how best to define "most important" in relation to the Company-Selected Measure or ranking other measures, if required, or whether to allow registrants to decide what they deem to be most important and then provide an explanation for their selection.

6. **Addressing Variations Over Time and Across Executives**: In situations when different measures are important in different years or for different executives, the SEC has requested comments on how to provide useful disclosures to investors. When the most important measure is already required to be disclosed in the Proposed Rule, the SEC is considering what should be required for the Company-Selected Measure, if anything.

7. **Company-Selected Measure Restrictions**: The SEC requested comments on the benefits of allowing the Company-Selected Measure to be any measure that could be disclosed under the existing requirements (as opposed to being limited to financial performance of the registrant) and permitting flexibility in presenting the information (as opposed to requiring disclosure in tabular form).

8. **Company-Selected Measure Over Time**: The SEC is considering whether the Company-Selected Measure should be the same year to year, and, if not, how a registrant should best disclose such a change.

9. **Five Most Important Performance Measures**: The SEC solicited comments in regards to whether requiring a tabular list of the registrant's five most important performance measures used to determine compensation actually paid to executives would be useful to investors.

10. **Cost of Calculating the Five Most Important Performance Measures**: The SEC asked for input on the cost to a registrant to identify and rank the five most important performance measures; whether such a disclosure would contain sensitive or competitive information and whether any exemptions to such a requirement should be permitted.

11. **Overlap of the Five Most Important Performance Measures**: In the event the five most important performance measures include one or more of the measures already required to be disclosed by the Proposed Rules, or a registrant considers fewer than five

measures in determining compensation, the SEC asked stakeholders what requirements should be imposed on a registrant.

12. **Tabular Format of the Five Most Important Performance Measures**: The SEC requested comments on the value of a tabular format for the five most important performance measures and whether such a format would be unduly burdensome or hinder registrants from providing useful disclosure.

13. **Expanded Disclosure Requirements**: The SEC solicited feedback on the value of requiring registrants to disclose all of the performance measures that actually determine executive compensation either in addition to, or in lieu of, the Proposed Rules and the additional measures under consideration.

14. **Voluntary Disclosures**: The SEC asked stakeholders whether the ability of registrants to voluntarily supplement the Proposed Rules with additional disclosures would be more useful than additional required disclosures or whether voluntary disclosures would be difficult to compare across registrants and be overly subjective.

15. **Smaller Reporting Companies**: The number of smaller reporting companies ("SRCs") increased to approximately 45 percent of registrants subject to the proposed rules, from approximately 40 percent at the time the Proposed Rules were published. In light of this increase, the SEC inquired whether it should reconsider the scaled requirements for SRCs in the Proposed Rules and additional measures under consideration.

16. **Burden on Smaller Reporting Companies**: The SEC requested comments on the burden if SRCs were subject to the additional rules covered in this release and what would be the value to investors.

17. **Expand Inline XBRL**: The SEC has proposed that values disclosed in the required table and certain other disclosures be block-text tagged using XBRL and is considering whether specific data points within the footnote disclosure should be separately tagged using Inline XBRL (in lieu of, or along with, the proposed block-text tagging). The SEC asked stakeholders whether Inline XBRL detail tagging would be valuable.[6]

18. **Compensation Actually Paid**: The SEC noted that some commenters to the Proposed Rules noted that the definition of compensation actually paid may result in some misalignment between the time period to which pay is attributed and the time period in which the associated performance is reported. The SEC requested suggestions of alternative approaches to reduce the risk of misalignment and asked whether the inclusion of additional measures of financial performance would affect this potential mismatch.

19. **Pension Service Cost as Part of Compensation Actually Paid**: In response to commenters to the Proposed Rules noting challenges with using the pension service cost as defined by applicable accounting standards as part of compensation actually paid, the SEC asked stakeholders for alternative measures of the change in pension value to better represent what is "actually paid" to the executive while also reducing the burden on the registrant and preserving value for investors.

20. **Fair Value of Options as Part of Compensation Actually Paid**: In response to potential challenges associated with computing the fair value of options at the vesting date as opposed to the grant date, the SEC solicited any simplifications or other adjustments that would mitigate these challenges.

21. **Time Periods for Total Shareholder Return**: The SEC asked for comments on specifying a certain time period for calculating total shareholder return (e.g., a five-year cumulative and rolling average, a cumulative average or an annual year-over-year figure).

22. **Other Developments**: Finally, the SEC solicited comments in respect of any additional developments since the original Proposed Rules that it should consider, including any

changes in methodologies and estimates used to assess the economic impact of the Proposed Rules.

The release was published in the Federal Register earlier today, and the comment period will remain open to the public until March 4, 2022, 30 days following the date of publication. Comments may be submitted by mail or online through the SEC website. The SEC stated that previously submitted comments are not required to be resubmitted and will be considered, although it is possible that resubmitting comments will have an optic impact.

CHAIR'S STATEMENT ON THE REOPENING AND LOOKING AHEAD

In commending the decision to reopen the comment period, Chair Gensler stated that the SEC is "considering whether additional performance metrics would better reflect Congress's intention in the Dodd-Frank Act and would provide shareholders with information they need to evaluate a company's executive compensation policies."[7] Chair Gensler noted that "[i]f adopted, this proposed rule would strengthen the transparency and quality of executive compensation disclosure."[8]

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ENDNOTES

[1] *Reopening of Comment Period for Pay Versus Performance* (SEC Release No. 34-94074), *available at* https://www.sec.gov/rules/proposed/2022/34-94074.pdf.

[2] *SEC Proposes Pay-for-Performance Disclosure Rule*, *available at* https://www.sullcrom.com/sec-proposes-pay-for-performance-disclosure-rule and Update: *SEC Publishes Text of Proposed Pay-Versus-Performance Disclosure Rule*, *available at* https://www.sullcrom.com/update-sec-publishes-text-of-proposed-pay-versus-performance-disclosure-rule.

[3] *Reopening of Comment Period for Pay Versus Performance* (SEC Release No. 34-94074), *available at* https://www.sec.gov/rules/proposed/2022/34-94074.pdf.

[4] In a footnote to its recent release, the SEC remarked that "there has been a continued increase in the prevalence of performance-contingent share plans and a decrease in the use of stock options to compensation CEOs among S&C 500 and Russell 3000 companies," and that "the COVID-19 pandemic has affected both how and the extent to which companies recently have tied executive compensation to company performance." *Id.* at 7, n.11.

[5] *Id*. at 17.

[6] In a footnote to its recent release, the SEC noted it is considering using Inline XBRL, rather than XBRL, for the proposed tagging requirements, to align the rules with the Inline XBRL tagging requirements for registrant financial statements. *Id*. at 6, n.9. and at 24, n.25.

[7] *SEC Reopens Comment Period for Pay Versus Performance*, *available at* https://www.sec.gov/news/press-release/2022-11.

[8] *Id.*

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