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To the Point

SEC — final rule

SEC requires disclosures about the relationship between executive pay and financial performance

Calendar year-end registrants will need to include these disclosures in their proxy statements in early 2023.

What you need to know

- The SEC adopted rules that require registrants to disclose the relationship between their executive compensation and financial performance (e.g., total shareholder return, net income, a company-selected measure) in a table for the five most recently completed fiscal years.
- The rules apply to all registrants except emerging growth companies, foreign private issuers and registered investment companies other than business development companies. They also provide certain relief to smaller reporting companies.
- Registrants must begin providing the disclosures in proxy and information statements that are required to include executive compensation information for fiscal years ending on or after 16 December 2022, meaning in early 2023 for calendar-year companies.

Overview

The Securities and Exchange Commission (SEC) adopted **final amendments** to Regulation S-K to require registrants to provide a table in their proxy and information statements that discloses the relationship between their executive compensation and financial performance for their five most recently completed fiscal years.

The amendments are intended to provide investors with more transparent and comparable disclosures of registrants' executive compensation in the context of their financial performance. The disclosures were mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act and originally proposed by the SEC in 2015.

Key considerations

New Item 402(v) of Regulation S-K requires registrants to include pay versus performance (PvP) disclosures in proxy statements for annual or special shareholder meetings (i.e., Schedule 14A) or information statements (i.e., Schedule 14C) in which executive compensation disclosures are required under Item 402.

The rules apply to all reporting companies, except emerging growth companies (EGCs), foreign private issuers and registered investment companies other than business development companies, though smaller reporting companies (SRCs) will be permitted to provide scaled disclosures.

Pay versus performance table

Registrants are required to disclose the following information in a table for up to five years:

- Total executive compensation reported in the summary compensation table for the principal executive officer (PEO) and the average total compensation for the other named executive officers (NEOs)
- The "actual" compensation paid to the PEO and the average "actual" compensation paid to the other NEOs, based on total compensation disclosed in the summary compensation table under Item 402(c) in the proxy or information statement, with certain adjustments for pensions and equity awards
- Total shareholder return (TSR) of the registrant and its peer group, both calculated as the value of an initial $100 investment
- The registrant's net income
- The most important financial performance measure the registrant uses to link compensation paid to its NEOs to company performance for the most recently completed fiscal year (company-selected measure)

The new table will look like this:

Pay versus performance table								
(a)	*(b)*	*(c)*	*(d)*	*(e)*	*(f)*	*(g)*	*(h)*	*(i)*
Year	Summary compensation on table total for PEO	Compensation actually paid to PEO	Average summary compensation on table total for non-PEO NEOs	Average compensation actually paid to non-PEO NEOs	*Value of initial fixed $100 investment based on:*		Net income	Company-selected measure
					Total share-holder return	Peer group total share-holder return		

How we see it

Some registrants already include some of this information for their chief executive officer in their proxy or information statements, but they don't currently provide the disclosure for all NEOs.

Registrants also must provide a footnote to the table describing any amounts deducted from and added to those in the summary compensation table to calculate "actual" executive compensation paid and the names of the NEOs whose compensation amounts are included for each year.

If a registrant selects a non-GAAP measure as its company-selected measure, the disclosure won't be subject to the general rules regarding disclosures of non-GAAP financial measures.

To compute actual compensation paid, registrants are required to make certain adjustments to the total executive compensation reported in the summary compensation table for pension and equity awards that are calculated in accordance with US GAAP. For equity awards, a registrant would first deduct the grant date fair value of equity awards granted during the year that are reported in the summary compensation table and add back the fair value of the equity awards in the year of grant and then report changes in the value of the awards from year to year until the awards vest. Pension amounts would be adjusted by deducting the change in pension value reflected in the summary compensation table and adding back the actuarially determined service cost for services rendered by the executive during the applicable year and the prior service cost (i.e., the entire cost of benefits granted in a plan amendment (initiation) during the covered fiscal year that are attributed by the benefit formula to services rendered in periods prior to the plan amendment or initiation).

How we see it

Although the data used in determining the executive compensation actually paid is derived from the GAAP financial statements and subject to internal control over financial reporting, registrants should start to establish a process to compile the new PvP disclosures.

If more than one person served as PEO during the year, the total compensation paid to each PEO must be included in a separate column in the table.

SRCs are not required to make the adjustments in pension amounts when calculating executive compensation actually paid or disclose their peer group's TSR, the company-selected measure or the list of their most important measures discussed below.

TSR is calculated as the sum of (1) cumulative dividends (assuming dividend reinvestment) and (2) the increase or decrease in the company's stock price for the year, divided by the share price at the beginning of the year, as required by Item 201(e) of Regulation S-K. The registrant determines its peer group using (1) a published industry or line-of-business index, (2) peer companies selected in good faith or (3) registrants with similar market capitalization, if certain criteria are met.[1,2]

Under the new rules, the company-selected measure of performance that registrants other than SRCs disclose can be a non-GAAP financial measure. If that's the case, the general rules regarding the use of non-GAAP financial measures (i.e., Regulation G and Item 10(e) of Regulation S-K) won't apply, consistent with the current Compensation Discussion and Analysis (CD&A) provision. However, the registrant must disclose how the number is calculated from the amounts in its audited financial statements. If the same non-GAAP financial measure is used elsewhere in a registrant's filing, the general rules on non-GAAP measures would apply.

Registrants are required to include the company-selected measure in a list of three[3] to seven of the most important financial performance measures they use to link executive compensation actually paid to company performance for the most recent fiscal year. The list can also include nonfinancial performance measures.

Description of relationship between pay and performance

In addition to providing the new table, registrants are required to describe (1) the relationship between the actual executive compensation they paid and their financial performance, including the TSR, net income and the company-selected measure and (2) the relationship between the company's TSR and the TSR of its selected peer group. The relationships can be described in words, graphics or a combination of both. For example, a registrant may show the percentage change for each year in both executive compensation actually paid and TSR together with a brief description of the relationship.

Registrants may supplement the disclosure with alternative performance measures (e.g., disclose realized pay by adding a new column in the table) that provide useful information about the relationship between executive compensation and performance, but those disclosures may not be misleading or presented more prominently than the required disclosures. Each additional performance measure must be accompanied by a clear description of the relationship between the compensation actually paid and the measure.

The rules do not specify the location of the PvP disclosures in the proxy or information statement. The PvP disclosures could be included in CD&A if they were considered in compensation decisions.

Transition

Registrants must begin providing these disclosures in proxy and information statements that are required to include Item 402 executive compensation disclosure for fiscal years ending on or after 16 December 2022 (i.e., in early 2023 for calendar-year registrants).

In the first proxy or information statement filings after the compliance date, all registrants except SRCs are only required to provide the PvP disclosures for three years and may add information for each additional year in their second and third filings. SRCs may provide the PvP disclosures for two years instead of three years in their first filings and add one additional year in the following year.

Newly public non-EGC registrants are only required to provide disclosures for years in which they were considered reporting companies. For example, a registrant that completed an initial public offering (IPO) and became a reporting registrant in 2023 would be required to provide disclosures only for 2023 (for the period following the IPO date) in its first annual proxy statement filed in 2024. In its 2025 proxy statement, the registrant would only be required to provide the disclosures for 2023 and 2024.

Endnotes:

[1] For example, weighted according to the issuers' stock market capitalization at the beginning of each period for which a return is indicated, using either the same peer group as used in Item 201(e) of Regulation S-K or a peer group used in the CD&A.

[2] If the peer group is not a published industry or line-of-business index, registrants are required to disclose the peer group in a footnote, consistent with the approach taken in Item 201(e) of Regulation S-K.

[3] A registrant using less than three performance measures is only required to disclose the measures it actually uses.