The SEC Adopts Pay-Versus-Performance Disclosure Requirements for Executive Compensation—Do They Relate to You?

Labor & Employment Law Update

By Kelly Haab-Tallitsch on September 26, 2022

On August 25, 2022, the U.S. Securities and Exchange Commission (SEC) voted to adopt the "pay-versus-performance" rule, requiring publicly traded companies (except foreign private issuers, registered investment companies, and Emerging Growth Companies) to provide clear disclosure to shareholders on the relationship between companies' executive compensation and financial performance. The adoption finally implements Section 14(i) of the Securities and Exchange Act of 1934 (the "Exchange Act"), as added by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

The SEC first issued a proposed "pay for performance" rule in April 2015. The proposal was never finalized and the SEC reopened the public comment period on the proposal in January 2022. A slightly revised version of the proposed "pay for performance" rule was adopted in August 2022 as paragraph (v) to Item 402 of Regulation S-K.

Disclosure Requirements

Under new Item 402(v) of Regulation S-K, public companies are required to provide a "pay-for-performance" table disclosing how compensation paid to executives relates to company financial performance for the last five fiscal years (three years for Smaller Reporting Companies ("SRCs")) in their proxy statement or other information statements requiring Item 402 compensation disclosure.

The "pay for performance" table must include the total compensation as reported in the Summary Compensation Table and a measure reflecting "executive compensation actually paid," as specified by the rule, for the principal executive officer (PEO) and, as an average, the other named executive officers (NEOs). The financial performance measures to be included are: (i) total shareholder return ("TSR") for the company; (ii) TSR for the company's peer group; (iii) the company's net income; and (iv) a financial performance measure chosen by and specific to the company that represents the most important

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financial performance measure it uses to link executive compensation actually paid to company performance for the most recently completed fiscal year.

Public companies must use the information in the pay-versus-performance table to provide a clear description of the relationships between each of the financial performance measures included in the table and the executive compensation actually paid to its PEO and, on average, to its other NEOs over the last five fiscal years. Companies must also describe the relationship between its TSR and its peer group TSR over the same period.

Finally, using the same approach as (iv) above, public companies must provide a list of three to seven financial performance measures that it deems most important in linking executive pay to company performance for the most recent fiscal year. Nonfinancial performance measures may be included in the list if the company determines that such measures are among its three to seven "most important" performance measures, and at least three financial performance measures have already been disclosed.

Disclosures for Smaller Companies

Scaled down disclosure requirements are available to SRCs, as defined in Item 10 (f)(1) of Regulation S-K. Notably, SRCs are not required to (1) report data for the fourth and fifth most recent fiscal years, (2) report their peer group TSR, (3) select an additional financial performance measure for the pay-versus-performance table, or (4) provide the list of three to seven financial performance measures.

Implementation Timing

Companies must begin complying with these disclosure requirements in proxy and information statements for fiscal years ending on or after December 16, 2022 (i.e., 2023 proxy and information statements for calendar year companies).

Under the transition rules, companies are not required to provide all five years of data in the first proxy or information statement for which the disclosures apply. Companies are required to disclose three years in the first proxy or information statement subject to the disclosures, and then another year in each of the subsequent years. Smaller Reporting Companies are initially required to provide the information for only two years, with the third year required in the following year.