Friday, August 26, 2022

More than seven years after issuing proposed rules, on August 25, 2022, the Securities and Exchange Commission (SEC) adopted final rules implementing the pay versus performance disclosure requirement mandated by the Dodd-Frank Act. Beginning with the 2023 proxy season, public companies will be required to include in proxy or consent solicitation material for an annual meeting of shareholders additional disclosure showing the relationship between executive compensation actually paid and the company’s financial performance.[1]

The rules generally apply to all public companies except foreign private issuers, registered investment companies, and emerging growth companies, and provide scaled disclosure requirements for smaller reporting companies (SRCs). Specifically, new Item 402(v) of Regulation S-K will require companies to disclose, in the tabular format pictured below, the following compensation and performance measures:

- **Compensation Measures:**
  - The total compensation for the principal executive officer (PEO) and, as an average, for the other named executive officers (NEOs) — these amounts will reflect the total compensation included in the Summary Compensation Table; and
  - The compensation “actually paid” for the PEO and, as an average, for the other NEOs, calculated per the rule — generally, these amounts will reflect the Summary Compensation Table total compensation, adjusted to (i) deduct the total aggregate change in the actuarial present value of all defined benefit and actuarial pension plans and add the aggregate of the
service cost for the applicable year and the “prior service cost” under such plans, each calculated in accordance with US GAAP, and (iii) revalue equity awards to reflect year-end or year-over-year changes in fair value, as prescribed by the rule, instead of grant date values.

- **Performance Measures:**
  - Total shareholder return (TSR) for the company;
  - TSR for the company’s peer group — for purposes of this disclosure, the peer group is either the peer group used by the company for purposes of its performance graph under Item 201(e) of Regulation S-K or a peer group referenced in the company’s Compensation Discussion and Analysis used for compensation benchmarking purposes;
  - The company’s net income; and
  - An amount attributable to a financial performance measure chosen by and specific to the company (the Company-Selected Measure) — this measure, selected from the Tabular List (described below), should represent the most important financial measure, not otherwise in the table, used by the company to link compensation actually paid to company performance.[2]

<table>
<thead>
<tr>
<th>Year</th>
<th>Summary Compensation Table Total for PEO</th>
<th>Compensation Actually Paid to PEO</th>
<th>Average Summary Compensation Table Total for Non-PEO NEOs</th>
<th>Average Compensation Actually Paid to Non-PEO NEOs</th>
<th>Value of Initial Fixed $100 Investment Based on:</th>
<th>Net Income</th>
<th>Company-Selected Measure</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(a)</td>
<td>(b)</td>
<td>(c)</td>
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</tbody>
</table>

* Indicates portions of the disclosure from which SRCs are exempt.

** A company does not need to include a Company-Selected Measure if the company does not use any performance measures or only uses measures already required by the table.

In addition to the tabular disclosure described above, companies must include a narrative or graphic description, or a combination of both, of the relationship between each financial performance measure included in the table and the executive compensation actually paid over the fiscal years required to be disclosed. A company must also describe the relationship between its TSR and its peer group TSR. The SEC encourages companies to present these relationships in a format that most clearly provides information to investors, based on the nature of each measure. For example, a line graph presenting executive compensation actually paid and change in the financial performance measures over the time
period or table showing the percentage change year over year could be used.

Finally, companies will be required to provide a Tabular List of at least three and up to seven financial performance measures that the company determines are its most important measures used to link executive compensation actually paid for the most recently completed fiscal year to performance. Companies may also include nonfinancial measures if they are considered most important, but the total number of performance measures (both financial and nonfinancial) may not exceed seven.

The rule provides companies with flexibility in determining where in the proxy or information statement to provide the required disclosure. Companies will be required to use Inline XBRL to tag their pay versus performance disclosure.

With respect to SRCs, the rules require SRCs to report on the three, not five, most recently completed fiscal years. This deviates from the SEC’s usual requirements for SRCs to generally only provide two years of executive compensation disclosure. An SRC must provide the information for two years in its first applicable filing, and add another year of disclosure the following year. SRCs will not be required to disclose pension amounts for the purpose of calculating executive compensation actually paid, and will not be required to present peer group TSR in the new table. Further, an SRC will have three years to comply with the Inline XBRL data tag requirements of the rule.

The above is only a summary of the new pay versus performance disclosure requirements. The rule is complex, and the calculations and assessments required to prepare the disclosures may be time-consuming. In addition, the disclosures will require input from the compensation committee and other constituencies within the company. Accordingly, we recommend that companies begin preparing this new disclosure well in advance of next year’s proxy season. For more detailed information on compliance with these new pay versus performance disclosure requirements, please contact Kelly Simoneaux at 504.582.8326 or ksimoneaux@joneswalker.com, or any member of our corporate, securities and executive compensation team.

FOOTNOTES
[1] Compliance will be required in the first proxy statement or information statement filed for fiscal years ending on or after December 16, 2022, and will be limited to instances where directors or say-on-pay provisions are up for vote at the company’s annual meeting.

[2] The rules permit companies to include additional Company-Selected Measures in the table, provided such additional measures do not obscure the required information.

[3] The SEC’s release notes that companies that do not use any financial performance measures to link executive compensation actually paid to company performance would not be required to present a Tabular List. However, we do not expect that this will apply to many companies.

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