

SEC Clarifies ‘Pay versus Performance’ Disclosure Rules

March 10, 2023

On February 10, the US Securities and Exchange Commission (SEC) issued 15 new [Compliance and Disclosure Interpretations \(C&DIs\)](#) to implement the “pay versus performance” (PvP) disclosure rules that were adopted on August 25, 2022 ([PvP Rules](#)). The PvP Rules added new Item 402(v) to Regulation S-K, which requires public companies to disclose the relationship between the executive compensation actually paid to the named executive officers (NEOs) and the financial performance of the company (Item 402(v)). The key requirement of the PvP Rules is the inclusion of a PvP table illustrating compensation actually paid to the NEOs (compared to the total or average compensation paid to such NEOs as reported in the Summary Compensation Table) for the five most recently completed fiscal years. The PvP table must include disclosure on company and peer total shareholder return (TSR), as well as company financial performance for such years. The PvP Rules also require disclosure through a tabular list of three to seven of the most important performance measures used to determine compensation for the current fiscal year.

Summary of the New Pay versus Performance C&DIs

This alert summarizes Sections 128D and 228D of the C&DIs, which provide clarifying guidance primarily in the form of a Q&A on 15 key aspects of the disclosure requirements under the PvP Rules:

- [PvP Disclosure Not Required in Form 10-K](#). While Form 10-K requires registrants to disclose executive compensation information as part of the Compensation Discussion and Analysis (CD&A), the inclusion of PvP disclosure in a registrant’s Form 10-K is not required. Rather, under Item 402(v), PvP disclosure must be included in any proxy or information statement where executive compensation disclosure is required, and any such PvP disclosure will not be deemed incorporated by reference into any other SEC filings unless the registrant expressly incorporates it by reference.
- [Prior Equity Awards to First-time NEOs Must Be Reflected in the PvP Table](#). Under Item 402(v), the change in the value of equity awards must be included in the calculation of a NEO’s “compensation actually paid” (CAP). Such equity award adjustment also applies to equity awards granted to a newly appointed NEO in the year prior to the year such executive became a NEO.
- **Clarification on the PvP table footnote disclosure:**
 - [First PvP Table Must Include Footnote on CAP Adjustments for All Years Presented](#). For the first year in which a registrant includes a PvP table in its proxy or information statement, Item 402(v) requires the registrant to disclose in a footnote all adjustments made for purposes of calculating CAP for each fiscal year presented in the PvP table. In subsequent years, such footnote disclosure is required only for the most recent fiscal year, unless disclosure for a prior fiscal year is material to an investor’s understanding of (1) the information reported in the PvP table for the most recent fiscal year, or (2) the relationship disclosure required between CAP and (a) cumulative TSR, (b) net income, and (c) the company-selected measure.

- [CAP Adjustments Must Not Be Aggregated](#). When including footnote disclosure on the adjustments made for purposes of calculating CAP, as required under Item 402(v), registrants must not aggregate pension value adjustments and/or equity award adjustments. Instead, registrants must provide footnote disclosure of each separate adjustment made pursuant to Items 402(v)(2)(iii)(B)(i)-(ii) and Items 402(v)(2)(iii)(C)(1)(i)-(vi).
- [Emerging From Bankruptcy](#). If a registrant emerges from bankruptcy and a new class of stock is issued under the bankruptcy plan, the registrant will present less than five full years of data in the stock performance graph required under Item 201(e) of Regulation S-K. For purposes of the TSR comparison required under Item 402(v)(2)(iv), the registrant in such scenario may provide its cumulative TSR and peer group TSR using the same measurement period that was used in the stock performance graph. The registrant must then include footnote disclosure explaining the approach taken and its effect on the PvP table.
- **Clarification on the peer group TSR disclosure:**
 - [Peer Groups Disclosed in CD&A May Be Used for Peer Group TSR Calculation](#). For purposes of calculating the peer group TSR required under Item 402(v), a registrant may use any compensation peer group that is disclosed in its CD&A, even if the selected peer group is not used for benchmarking practices, so long as the selected peer group is actually used by the registrant to determine executive pay.
 - [TSR Measurement Point for Newly Public Companies](#). If a registrant went public during the earliest year presented in the PvP table, then the measurement point for purposes of calculating the cumulative TSR and peer group TSR required under Item 402(v) should begin on the registration date.
 - [Peer Group Changes](#). With respect to a registrant that uses its CD&A compensation peer group for purposes of calculating its peer group TSR under Item 402(v), if the compensation peer group disclosed in such registrant's CD&A changes from year to year, the peer group selected for each year presented in the PvP table must correspond with the compensation peer group disclosed in the CD&A for such year.
- [Net Income Must Come From Audited GAAP Financial Statements](#). When disclosing net income or loss in the PvP table, as required under Item 402(v), a registrant must use the net income or loss as required by Regulation S-X to be disclosed in its audited GAAP financial statements but is not permitted to use other net income amounts presented in its audited financial statements, such as income or loss from continuing operations.
- **Clarification on the Company-Selected Measure (CSM):**
 - [A CSM that Is Derived From, a Component of, or Similar to Cumulative TSR and Net Income Is Permitted](#). Under Item 402(v), a registrant's CSM must be a financial performance measure that is not otherwise required to be disclosed in the PvP table (i.e., that is not either cumulative TSR or net income). However, a registrant's CSM can be (but is not required to be) a measure that is derived from, a component of, or similar to cumulative TSR and net income, such as earnings per share, gross profit, income or loss from continuing operations, or relative TSR.
 - [Stock Price Cannot Be Used as the CSM Unless Used to Link CAP to Performance](#). While stock price is considered a financial performance measure for purposes of Item 402(v), it cannot be used as a registrant's CSM unless the registrant uses stock price to link CAP to company performance. For example, stock price can be used as a registrant's CSM if the registrant's stock price is a market condition applicable to an incentive plan award or is used to determine the size of a bonus pool.
 - [The CSM Cannot Be Measured Over a Multi-year Period](#). The CSM cannot be measured over a multi-year period that includes the applicable fiscal year as the final year, even if such performance period is used consistently for all years presented in the PvP table. The CSM represents the most important financial performance measure (that is not otherwise required to be disclosed in the PvP table) used by a registrant to link CAP, for the most recently completed fiscal year, to company performance.

- **Tabular List and CSM Disclosures are Required if any Portion of NEO Compensation Is Tied to a Financial Performance Measure.** If a registrant pays discretionary bonuses based solely on satisfying a financial performance measure, then the registrant must make the tabular list and CSM disclosures required under Item 402(v), even though the bonus amounts are subject to discretion. For example, if a registrant uses a bonus pool whereby achievement of a financial performance measure is used to determine the availability or size of the pool, but the compensation committee has the discretion to allocate bonus payouts to individual participants, such financial performance measure must be disclosed. Because the size of the bonuses paid from the bonus pool is determined wholly or in part upon satisfying the financial performance measure, the registrant is using the financial performance measure to link CAP to company performance.
- **Aggregation of Compensation Paid to Multiple PEOs Is Permitted for Narrative and/or Graphical PvP Disclosure Requirements.** A registrant with multiple principal executive officers (PEOs) may aggregate the compensation paid to such PEOs in a given year for purposes of the narrative, graphical or combined comparison between (i) CAP and (ii) TSR, net income, and the CSM, to the extent that such presentation will not be misleading to investors. A registrant with multiple PEOs must still include separate columns for each PEO in the PvP table as required under Item 402(v).
- **'Stub Period' Following a Change of Fiscal Year Must Be Included in the PvP Table.** If a registrant changes its fiscal year, the registrant must include PvP disclosure for the "stub period" and must not annualize or restate compensation. Such registrant must include at least four periods in its first PvP table. For example, if a registrant changes its fiscal year from June 30 to December 31 in late 2022, then it must include the following four periods in its first PvP table: (i) July 1, 2022 to December 31, 2022 (the "stub period"); (ii) July 1, 2021 to June 30, 2022; (iii) July 1, 2020 to June 30, 2021; and (iv) July 1, 2019 to June 30, 2020. The registrant must continue providing such disclosure, including the "stub period," until there is disclosure for five full fiscal years after the "stub period."

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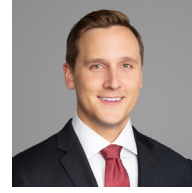
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