SEC Issues Guidance on New Pay versus Performance Disclosure

The Securities and Exchange Commission (SEC) staff has issued limited guidance on the new pay versus performance (“PvP”) disclosure. The guidance answers many, but certainly not all, questions that have arisen with regard to the PvP disclosure rules. Companies that have already drafted their PvP disclosures may wish to review their existing draft disclosures to confirm they are compliant with the newly-issued guidance and make adjustments, as needed.

On February 10, 2023, the SEC Division of Corporation Finance staff issued fifteen compliance and disclosure interpretations (C&DIs) FAQs, which address a limited number of issues on the PvP disclosure. These C&DIs are summarized below.

Calculation of Compensation Actually Paid (CAP)

- **Treatment of equity grants made prior to NEO status.** The calculation of CAP to a named executive officer (NEO) requires a company to make certain adjustments the NEO’s total compensation reported in the company’s Summary Compensation Table (SCT). The new guidance clarifies that equity awards granted to an employee prior to the year in which the employee became an NEO must be included in the calculation of CAP for the NEO (if such award was outstanding, forfeited or vested during a covered fiscal year).

Selection of Peer Group

- **Proxy-disclosed peer group used in relative performance awards may be selected as PvP table peer group.** A company must select as its PvP table peer group either (i) its proxy-disclosed peer group or (ii) industry or line-of-business index or issuers (i.e., custom peer group of issuers) used in the company’s performance graph that is disclosed in the annual report/Form 10-K. The SEC staff has clarified that a proxy-disclosed peer group is not limited to the peer group used to benchmark compensation but also includes a peer group used to help companies determine executive pay. This suggests that the PvP table peer group may be a company’s proxy-disclosed performance peer group used in relative total shareholder return (TSR) incentive awards (or awards with other relative metrics).

Calculation of Peer Group TSR Disclosed in PvP Table

- **Determination of TSR (i) for IPO companies and bankrupt emergent companies and (ii) when peer group composition changes.** The PvP table is required to include a company’s cumulative TSR and the company-selected peer group’s cumulative TSR over multiple measurement periods based on an assumed investment of $100. With regard to the TSR calculation, the SEC clarified the following:

— In the case of a company that went public during a covered fiscal year (i.e., during 2022, 2021 or 2020 for the initial disclosure), the measurement period begins on the date the company's securities were registered under Section 12 of the Securities Exchange Act of 1934.

— In the case where the composition of a company-selected PvP table proxy peer group was not the same for each of the covered years, the company must calculate TSR for a given year based on the composition of the peer group for that year.

— In the case of a company that emerged from bankruptcy during the period covered by the PvP table, the company may provide its cumulative TSR and peer group cumulative TSR using a truncated measurement period starting from the date on which the company's newly issued stock started trading following emerging from bankruptcy.

Performance Measures Disclosed in PvP Table

- **Net income must reflect audited GAAP net income.** The PvP table must include a net income column under which a company must disclose its net income for each covered fiscal year as disclosed in its audited GAAP financial statements. A company may not use other derivations of net income, such as net income from continuing operations, in lieu of reported net income.

- **Company-Selected Performance Measure ("CSM") may be a financial measure derived from PvP disclosed financial metrics or stock price but only if linked to achievement to pay outcomes.** The PvP table must include the following financial measures: (i) net income (ii) company cumulative TSR and (ii) a CSM. The CSM is the measure which in the company's assessment represents the *most important financial performance measure* (that is not otherwise required to be disclosed in the table) used by the company to link compensation actually paid to NEOs, for the most recently completed fiscal year, to company performance. With regard to the Company-Selected Measure, the SEC clarified the following:

  — A company may use a CSM that is derived from, a component of, or similar to financial measures that are required to be disclosed in the PvP table, such as earnings per share, gross profit, income or loss from continuing operations or relative TSR.

  — A company may use stock price as a CSM when stock price (i) is a market condition applicable to an incentive plan award (e.g., shares are earned based on achieved level of stock price), or (ii) is used to determine the size of a bonus pool.

  — In contrast, a company ***may not*** use stock price as its CSM when stock price is not linked to the earning or vesting of an incentive award, even though in the case of a share-based incentive award the value of such award is significantly influenced by changes in stock price.

  — The Company-Selected Measure *must be measured over a single fiscal year*, not over a multi-year period. It may not be measured over a multi-year period that includes the applicable fiscal year as the final year, even if such performance period would be used consistently for all years in the table.

Footnotes to PvP Table

- **Generally, reconciliation of CAP to SCT Pay need only cover the most recent fiscal year (separately, disclosed pension adjustments may not be aggregated)**. A company must provide a reconciliation between SCT total pay and CAP in a footnote to the PvP table. The SEC has clarified the following with regard to the footnote reconciliation:

— Generally, the footnote disclosure should solely cover the most recent fiscal year. However, for the initial year of the PvP disclosure, companies should provide the footnote disclosure for each of the fiscal years presented in the PvP table.

— Pension adjustments (i.e., the subtraction of SCT disclosed change in pension value and the addition of service cost) to SCT total pay may not be aggregated in the footnote disclosure.

Description of the Relationship Between CAP and Company Performance

- **Compensation Actually Paid to Multiple Chief Executive Officers (CEOs) for a given year may be aggregated in describing the relationship between CEO CAP and company performance.** A company may aggregate the compensation actually paid to multiple CEOs in a given fiscal year for purposes of the required disclosure on the relationship between CAP and the performance metrics included in the PvP table, as long as the presentation would not be misleading to investors. That is, if a company is including a graphical or narrative disclosure to describe the relationship between CEO CAP and the performance measures, such disclosure may present multiple CEOs CAP, in the aggregate, as long as it would not be misleading to investors.

Impact of Change in Fiscal Year on PvP Table

- **Stub year due to change in fiscal year must be disclosed as a separate period in PvP table.** If a company changes its fiscal year during the period covered by its PvP table, the company's PvP table should cover the "stub period" as a separately disclosed fiscal period, without annualizing compensation. This is consistent with the approach applicable to SCT disclosure for changes in fiscal year end.

Disclosure of Pay versus Performance in Form 10-K

- **PvP disclosure not to be included in Form 10-K filings.** PvP disclosures are not required to be included in a company's Form 10-K, even when the filing includes executive compensation disclosures, and will not be incorporated by reference, except to the extent that the company specifically does so. PvP disclosures are required to be included in any proxy or information statement for which executive compensation disclosure is required.

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