

CLIENT ALERT

Navigating Compensation Governance

SEC Issues Additional Guidance on Pay Versus Performance Disclosure

The Securities and Exchange Commission staff has issued additional guidance on the pay versus performance (PvP) disclosure rules.

This guidance includes revisions to prior guidance and new guidance on several issues related to the PvP disclosure.

Background

Companies are required to disclose in their proxies a description of the relationship between “compensation actually paid” (CAP) to executive officers and the financial performance of the company for the five most recently completed fiscal years (3 for smaller reporting companies). On September 27, 2023, the SEC staff issued compliance and disclosure interpretations that addressed a limited number of issues on the calculation of fair value and CAP.

On November 21, 2023, the SEC staff issued additional compliance and disclosure interpretations that revised prior guidance and addressed a limited number of new issues related to the PvP disclosure. This guidance is summarized below.

Highlights of SEC Additional Guidance on PvP Disclosure

- Generally, an award holder’s attainment of retirement eligibility will **not** be considered a vesting date, which reverses prior SEC guidance.
- In a modification to prior guidance, the SEC will allow companies to determine peer group cumulative TSR for disclosure in the PvP table for each covered year solely based on the peer group for the reporting year (applies solely to CD&A selected peer groups).
- Under limited circumstances, the SEC eliminated the requirement for companies to provide comparative TSR information when the composition of a custom peer group changes year over year.

Summary of SEC Additional Guidance on PvP Disclosure

Determination of Vesting Date for Equity Awards Subject to a Retirement Provision.

- **Issue:** For stock and option awards that accelerate vesting upon an employee's retirement, should companies treat as a vesting date the date on which the employee becomes retirement eligible?
- **Answer:** Yes, but in highly limited circumstances. If retirement is the sole vesting condition of an equity award, then the award would be treated as vested when the award holder becomes retirement eligible. However, for an award with substantive conditions in addition to retirement eligibility, such other conditions must also be considered in determining when the award has vested. Other substantive conditions could include (i) a market condition or (ii) a condition that results in vesting upon the earlier of (x) the holder's actual retirement or (y) the satisfaction of the award's requisite service period.
- **Meridian comment:** This guidance revises the SEC staff's September guidance which suggested that retirement eligibility could be a vesting date. Based on previous and revised guidance, an award holder's attainment of retirement eligibility will apparently **not** result in a vesting date if the award includes one or more of the following provisions:
 - The award vests upon the earlier of actual retirement or satisfaction of a requisite service period, in which case the vesting date would be the date on which the requisite service period is satisfied.
 - The award is subject to a market condition (e.g., relative TSR performance goal), in which case the vesting date would be the date on which the market condition is measured (e.g., end of the applicable performance period).
 - The award is subject to a performance condition (e.g., a performance goal related to the operations of a company, such as a financial metric), in which case the vesting date would be the date on which the performance condition is measured (e.g., end of the applicable performance period).

Determination of Peer Group Total Shareholder Return (TSR) After Initial PvP Disclosure

- **Issue:** If a company selected custom peer group (i.e., that peer group disclosed in a company's CD&A) remained the same for 2020 and 2021, but changed for 2022, which peer group's TSR should be reflected in the PvP table?
- **Answer:** For the initial PvP disclosure, the company should have disclosed the TSR in the PvP table for each year using the peer group disclosed for that year. However, in subsequent years, companies should compute and disclose cumulative TSR in the PvP table based solely on the reporting year custom peer group. If the composition of the reporting year peer group differs from the prior fiscal year's peer group, then the company must provide a footnote disclosure to the PvP table (i) explaining the reason for the difference and (ii) showing a comparison of the company's cumulative TSR with that of both the newly selected peer group and the peer group used in the immediately preceding fiscal year.
- **Meridian comment:** This guidance represents a modification of the SEC staff's view on the determination of peer group TSR. Previous guidance required companies to separately compute cumulative TSR for each year's applicable peer group. The modified guidance allows companies to

calculate cumulative TSR based on the reporting year’s peer group. The following examples illustrate the new guidance (note: identical peer groups are indicated by the same capital letter):

Example 1:

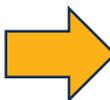
Fiscal Year	Peer Group (selected from CD&A)
2023	Peer Group C
2022	Peer Group C
2021	Peer Group B
2020	Peer Group A



Company would compute peer group cumulative TSR for each covered fiscal year solely based on Peer Group C

Example 2:

Fiscal Year	Peer Group (selected from CD&A)
2023	Peer Group C
2022	Peer Group B
2021	Peer Group B
2020	Peer Group A



Company would compute peer group cumulative TSR for each covered fiscal year solely based on Peer Group C. However, company would be required to disclose by footnote to the PvP table (i) the reason for the change from peer group B to C and (ii) a comparison of company cumulative TSR and peer groups’ B and C and cumulative TSR.

Under certain limited circumstances (described below in “Changes in Benchmarking Peer Groups”), the SEC will not require a company to include the above referenced footnote disclosure on comparative cumulative TSR.

Changes in Benchmarking Peer Groups

- **Issue:** If a company adds or removes companies from a custom peer group, is the company required to footnote the changes and compare cumulative TSR using the prior and current peer groups?
- **Answer:** Generally, yes. However, if a company’s custom peer group changes because either (1) a peer company is no longer in the same line-of-business or industry or (2) the subject company applied pre-established objective criteria to add or remove peer(s), then the company is not required to provide a comparison of TSRs of the prior and current custom peer groups. However, in such situations, the company must still provide a description of and the bases for the change in the peer group, including the names of the companies removed from its custom peer group.

Implications of Companies Losing Smaller Reporting Company (SRC) Status

- **Issue:** What are the implications for PvP disclosures if a company that previously qualified as an SRC (and whose prior proxy included scaled PvP disclosure covering 2021 and 2022) loses that status on June 30, 2023?
- **Answer:** The SEC staff provides the following guidance with respect to a company that loses its SRC status on June 30, 2023:
 - Proxy Filed Within 120 Days After the Company’s 2023 Fiscal Year. The company may include scaled PvP disclosure in such proxy.

- Proxy Filed in 2025. Generally, the company would need to include a full PvP disclosure in its 2025 proxy (assuming the company still fails to qualify as an SRC). However, SEC staff will not object if the PvP table only covers the years previously included in the company’s prior disclosures.
- No Revision of Prior Year Disclosures. Generally, the company will not be required to revise the disclosure for prior years to conform to non-SRC status, except with respect to calculation of TSR (see below).
- Calculation of Peer Group TSR. Because peer group TSR is calculated on a cumulative basis, the company should include peer group TSR for each year included in the PvP table, measured from market close on the last trading day before the company’s earliest fiscal year in the table.
- Company Selected Measure. The company must include its numerically quantifiable performance under the Company Selected Measure for each fiscal year in the PvP table.

Implications of Losing Emerging Growth Company (EGC) Status

- **Issue:** An EGC company is not required to include a PvP disclosure in its proxy. What are the implications of a company that previously qualified as an EGC that loses that status as of December 31, 2024? Is the company required to include the PvP disclosure in its 2025 proxy? How many years would be required to be covered by the company’s PvP table?
- **Answer:** The company would be required to include the following in its 2025 proxy:
 - The PvP disclosure must be included in the company’s 2025 proxy.
 - However, the company may apply the following transitional relief to its PvP table:
 - The initial year (2025) of disclosure the PvP table may cover 3 fiscal years
 - The second year (2026) of disclosure the PvP table may cover 4 fiscal years
 - The third year (2027) of disclosure and beyond the PvP table must cover 5 fiscal years

Reinforcement of Existing PvP Rules

The following SEC staff guidance simply reinforced and/or clarified existing rules (without providing new or revised guidance):

- Treatment of Dividends/Dividend Equivalents. The calculation of executive “compensation actually paid” must include dividends or dividend equivalents paid to an NEO that are not already reflected in the fair value of stock awards or included in another component of total compensation.
- Selection of Peer Group. A company’s PvP table must include a company selected peer group, which may be either (i) the peer group disclosed in the company’s CD&A or (ii) the industry or line-of-business index disclosed in a company’s performance graph (other than a broad-based index such as the Russell 3000). If a company’s performance graph includes two or more indices, a company may select either index for its PvP peer group, in which case the company should disclose by footnote to the PvP table the index chosen.
- Prohibition of Selection of Broad-Based Index as Company’s Peer Group. As noted above, the PvP disclosure rules permit a company to select the index used in its performance graph other than a broad-based index. The PvP rules also allow a company to select the peer group disclosed in its CD&A as its peer group for PvP table purposes. This peer group may be either the peer group used to benchmark executive compensation, or the peer group used in a relative TSR award. However, if

the peer group is a broad-based index, such peer group may not be the peer group included in the PVP table.

- Determination of Average CAP when Company has Multiple CFOs. If two or more individuals served as CFO during a fiscal year, a company may not treat such individuals as equivalent of one NEO when determining the average compensation for the NEOs other than CEO. Each CFO must be included individually in the calculation of average compensation amounts.

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The *Client Update* is prepared by Meridian Compensation Partners' Governance and Regulatory Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-347-2524 or dkalfen@meridiancp.com.

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