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On August 25, 2022, the U.S. Securities and Exchange Commission ("SEC") adopted final rules implementing the "pay versus performance" provisions of the Dodd-Frank Act. New Item 402(v) requires the disclosure of information that shows the relationship between executive compensation actually paid and the financial performance of the issuer, which includes:

- a new pay-versus-performance table, containing (1) the summary compensation table total and the total "executive compensation actually paid" for the CEO and for the other named executive officers ("NEOs") as an average; (2) total shareholder return ("TSR") for both the registrant and its peer group; (3) net income; and (4) a "company-selected measure," reported for up to five years (starting with three years for the first filing). The calculation of "executive compensation actually paid" includes adjustments from the summary compensation table totals for both pension benefits and equity awards;

- accompanying narrative or graphical disclosures, providing a clear description of (1) the relationships between executive compensation actually paid to the CEO and other NEOs (on average) and (a) the registrant's TSR, (b) the registrant's net income and (c) the company-selected measure, in each case over the period of time included in the pay-versus-performance table, and (2) the relationship between the registrant's TSR and its peer-group TSR, in each case over the same period of years; and

- a tabular list of the three to seven most important performance measures used by the registrant to link executive compensation actually paid to its CEO and NEOs during the most recently completed fiscal year to company performance.

We have prepared this set of Q&As to assist our public company clients in complying with these new disclosure requirements.
OVERVIEW

1. What disclosures are required by the new pay-versus-performance rules?

New Item 402(v) of Regulation S-K requires the disclosure of information that shows the relationship between executive compensation actually paid and the financial performance of the issuer, which includes (1) a new pay-versus-performance table, (2) accompanying narrative or graphical disclosures and (3) a tabular list of the three to seven most important performance measures used to link executive compensation to company performance. In adopting the rules, the SEC stated that it had exercised its discretion to provide for a consistent format intended to further the statutory objectives of making pay-versus-performance data clear and easy for investors to evaluate.

Each of these items is discussed in greater detail in the Q&As below.

2. What registrants must comply with new Item 402(v)?

The rules apply to all reporting companies other than emerging growth companies, registered investment companies, foreign private issuers and companies with reporting obligations only under Section 15(d) of the Exchange Act (which are not subject to the proxy rules). Smaller reporting companies can provide reduced disclosures under the rules, as described in Q&A 27 below.

3. When are the disclosure rules effective?

Public companies must include these disclosures in proxy and information statements for fiscal years ending on or after December 16, 2022, meaning the first disclosures under this rule will be made beginning in the 2023 proxy season.

NEW PAY-VERSUS-PERFORMANCE TABLE

4. At a high level, what information is required to be included in the pay-versus-performance table?

New Item 402(v) of Regulation S-K requires registrants to include a pay-versus-performance table in their proxy or information statement reporting, for each year in the table, the following information in separate columns:

- the summary compensation table total for the CEO;
- the total “executive compensation actually paid” to the CEO;
- the average summary compensation table total for the other NEOs;
- the average total “executive compensation actually paid” to the other NEOs;
cumulative TSR for the registrant, expressed as the value of an initial fixed $100 investment based on TSR; 
- TSR for the registrant’s peer group, expressed as the value of an initial fixed $100 investment based on peer-group TSR; 
- the registrant’s net income; and 
- the “company-selected measure”—a financial performance measure chosen by the registrant that, in the registrant’s assessment, represents the most important performance measure used by the registrant to link executive compensation actually paid to the NEOs to company performance.

5. How many years of information are reported in the pay-versus-performance table?

The pay-versus-performance table requires the above information for the five most recently completed years with two transition relief rules:

- For the initial filing in which a registrant provides the pay-versus-performance disclosure, disclosure of only three years is required. Disclosure of an additional year is required in each of the two subsequent annual filings. (As an example, for registrants with a December 31 fiscal year end, the 2023 proxy will include disclosure for 2022, 2021 and 2020; the 2024 proxy will include disclosure for 2023, 2022, 2021 and 2020; the 2025 proxy will include disclosure for 2024, 2023, 2022, 2021 and 2020.)

- For new public companies, disclosure for years prior to the last completed year is not required if the registrant was not a reporting company pursuant to Section 13(a) or Section 15(d) of the Exchange Act at any time during that year.

In addition, smaller reporting companies have scaled reporting requirements as described in Q&A 27 below.

6. What compensation information is included in the pay-versus-performance table for the CEO?

The pay-versus-performance table requires separate columns disclosing (1) the CEO’s summary compensation table total and (2) the “executive compensation actually paid” to the CEO for each applicable year.

7. What if the registrant has more than one CEO in a given year?

In any year in which a registrant has multiple CEOs, the pay-versus-performance table must include separate columns for each of the CEOs. A footnote to the table should include the name of each CEO.
8. What compensation information is required for the named executive officers who are not the CEO?

For the non-CEO NEOs for whom disclosure is required in the summary compensation table for the applicable year, the pay-versus-performance table reports only (1) the average summary compensation table total and (2) average total executive compensation actually paid to this group. Footnotes are required reporting the names of the individual NEOs whose compensation is included in the average for each year.

9. How is “executive compensation actually paid” calculated?

To calculate executive compensation actually paid for the CEO and other NEOs for a given year in the pay-versus-performance table, start with the total compensation as reported in the summary compensation table for the applicable year, and then make the adjustments described below with respect to pension benefits (see Q&A 10) and stock and option awards (see Q&As 11-13).

The final rules require registrants to “show their work” in calculating executive compensation actually paid, mandating footnote disclosures of each of the amounts deducted from and added to the summary compensation table totals. For the non-CEO NEOs, these values in the footnotes should be expressed as averages.

10. What pension benefit adjustments are made to the summary compensation table totals to calculate executive compensation actually paid?

For any pension benefits:

- **subtract** the aggregate change in the actuarial present value of all defined benefit and actuarial pension plans (if positive) reported in the summary compensation table; and

- **add** the service cost during the applicable year (i.e., the actuarially determined service cost for services rendered by the executive during the year) plus, the prior service cost (i.e., the cost of benefits granted, or credit for benefits reduced, in a plan amendment or initiation during the year that are attributed by the benefit formula to services rendered in periods prior to the amendment), in each case calculated in accordance with GAAP. The adjustment does not distinguish between vested and unvested benefits.

The SEC's view is that the above formula reflects the value that would be set aside by the registrant to fund pension benefits payable upon retirement to each executive for services provided during the applicable year and any plan amendments made during the year. Calculating service cost and prior service cost for the NEOs will require the collection of necessary accounting and actuarial data on a per-participant basis.
11. What equity award adjustments are made to the summary compensation table totals to calculate executive compensation actually paid?

For any stock and option awards:

- **subtract** the grant date fair value of any stock and option awards granted during the applicable year reported in the summary compensation table;
- for new stock and option awards granted during the year, **add** the fair value of these awards as of the end of the year (or as of the vesting date if during the year);
- for outstanding stock and option awards granted in prior years, **add** the change in fair value of these awards from the end of the prior year to the end of the applicable year (or to the vesting date if during the year), whether positive or negative;
- for any awards granted in prior years that are determined to fail to meet the applicable vesting conditions during the applicable year, **subtract** an amount equal to the fair value as of the end of the prior year; and
- **add** the dollar value of any dividends or other earnings paid on the awards during the applicable year prior to the vesting date that are not otherwise reflected in the fair value of the award or included in any other category of total compensation for the applicable year.

Although the above formula appears complex, the essential rule of these stock and option award adjustments is that the first fair value disclosure of an award is made in the year of grant, and then changes in the fair value of the award are reported from year to year until the vesting date (or the date the company determines the award will not vest).

12. How will the annual valuations of stock and option awards required by new Item 402(v) for purposes of calculating “executive compensation actually paid” differ from a registrant’s current valuation processes?

The annual stock and option valuations mandated by the final rules will require the input of the registrant’s human resources, finance and legal teams, along with the assistance of outside advisors. For stock awards, the annual valuation mandated by the final rules generally entails calculations that are already done for purposes of financial statement reporting—i.e., consideration of the prevailing stock price and, with respect to performance-based stock awards, any changes with respect to the probable outcome of performance conditions as of the last day of the applicable year. However, for options and stock awards with market-based conditions, the annual valuation of these awards will require registrants to produce new valuations with updated assumptions for each outstanding award; performing these computations on an annual basis is typically not necessary for financial statement reporting purposes.
The final rules require footnote disclosure of any assumption made in the valuation that differs materially from those disclosed as of the grant date of the equity awards.

13. Will the registrant be required to include any value for equity awards in the pay-versus-performance table after the vesting date?

No. Although “vesting date” is not a defined term, the SEC provides in the adopting release that the reporting does not include adjustments to account for post-vesting changes or executives’ continued exposure to registrant performance after an equity award vests (e.g., due to restrictions on the transfer or monetization of equity, such as delayed option exercisability, anti-hedging, holding, and mandatory deferral requirements).

14. What financial performance measures are included in the pay-versus-performance table for each applicable year?

The pay-versus-performance table requires disclosure of four financial performance measures for each year in the table: (1) TSR, (2) peer-group TSR, (3) net income and (4) a company-selected measure.

15. How are TSR and peer group TSR reported?

The table must include cumulative TSR for the registrant, together with TSR of a peer group (weighted according to the respective issuers’ stock market capitalization at the beginning of each period for which a return is indicated). TSR amounts reported in the table are calculated based on an initial fixed investment of $100.

16. How is the TSR peer group selected, and what disclosures are required?

The peer group selected by the registrant for purposes of calculating peer-group TSR will be either (1) the same peer group included in the stock performance graph in the registrant’s annual report under Item 201(e) of Regulation S-K or (2) a peer group used in the Compensation Discussion & Analysis for purposes of disclosing the registrant’s benchmarking practices. If the peer group is not an industry or line-of-business index, the identity of the issuers in the group must be disclosed in a footnote (or incorporated by reference to a prior filing).

17. What if a registrant changes its peer group?

If a registrant changes its peer group in a given year, the final rules require (1) disclosure of peer-group TSR for the new peer group for all years in the pay-versus-performance table (including prior years), and (2) the registrant must explain in a footnote the reasons for the peer group change and compare the registrant’s TSR to that of both the new peer group and the peer group used in the immediately preceding year.
18. What is a “company-selected measure,” and how is it determined?

The final rules require inclusion in the pay-versus-performance table of a company-selected measure—which is a financial performance measure that in the registrant’s assessment represents the most important measure used by the registrant to link executive compensation actually paid during the year to company performance (other than TSR and net income).

A “financial performance measure” means a measure that is determined and presented in accordance with the accounting principles used in preparing the registrant’s financial statements, any measure that is derived wholly or in part from such measure(s), stock price or TSR. There is no requirement that a financial performance metric be presented within the registrant’s financial statements or otherwise included in a filing to be a company-selected measure.

The determination of “most important” should be based on the most recently completed year. As a result, the company-selected measure may change from one filing to the next, but the pay-versus-performance table must include disclosure of the measure for each of the five required years.

19. Is the registrant required to disclose the methodology for calculating the company-selected measure?

In general, the methodology used to calculate the measure is not required to be disclosed; however, if the measure is a non-GAAP financial measure, the registrant must provide disclosure as to how the number is calculated from the audited financial statements (but is not otherwise subject to the rules regarding disclosure of non-GAAP financial measures under Regulation G and Item 10(e) of Regulation S-K).

20. Can a registrant include additional performance measures in the pay-versus-performance table?

Registrants are permitted to voluntarily report additional financial or non-financial performance measures as new columns in the table, but the additional disclosures may not be misleading or obscure, or be presented with greater prominence than, the required information. For example, if the registrant changes the company-selected measure from that used in the prior year, the registrant may elect to include a column showing the applicable multiple-year performance against the previously used measure in addition to the newly selected company-selected measure.
21. What additional disclosures are required by new Item 402(v) with respect to the information disclosed in the pay-versus-performance table?

The new pay-versus-performance table is to be supplemented by disclosure providing a clear description of the relationships between:

- (a) executive compensation actually paid to the CEO and (b) the average of the executive compensation actually paid to the other NEOs, and each of (i) cumulative TSR, (ii) net income, and (iii) the registrant’s company-selected measure (and any other measures voluntarily disclosed in the table), in each case across the fiscal years included in the required pay-versus-performance table (reflecting any applicable transition relief); and

- the registrant’s TSR and the TSR of the registrant’s peer group over the applicable fiscal years.

22. What is the format for this “relationship disclosure”?

The disclosure can be graphical, narrative or a combination of the two, in the determination of the registrant. In the adopting release, the SEC “encourage[s] registrants to present this disclosure in the format that most clearly provides information to investors about the relationships, based on the nature of each measure and how it is associated with executive compensation actually paid.” Registrants can group any of these relationship disclosures together, but any combined description must remain clear.

The SEC provides two possible examples for this relationship disclosure: The first is a graph providing executive compensation actually paid and change in the financial performance measure(s) on parallel axes and plotting compensation and such measure(s) over the applicable time period. The second example is narrative or tabular disclosure showing the percentage change over each year of the applicable period in both executive compensation actually paid and the financial performance measure(s), together with a brief discussion of how those changes are related.
TABULAR LIST OF “MOST IMPORTANT” PERFORMANCE MEASURES

23. What are some key considerations in preparing the tabular list of the most important performance measures required by new Item 402(v)?

The final rules require registrants to provide a tabular list of the most important performance measures used by the registrant to link executive compensation actually paid to the NEOs to company performance during the most recently completed year. Some key considerations about the list are as follows:

- The list should include at least three and not more than seven performance measures. However, if the registrant considers fewer than three financial performance measures when it links executive compensation actually paid during the year to company performance, the registrant will be required to disclose only the number of measures it actually considers.
- The determination of “most important” is made on the basis of the most recently completed fiscal year, rather than over the number of years included in the pay-versus-performance table (as had been proposed in the 2022 reopening release).
- The list is not required to be ranked.
- The list must include the company-selected measure reported in the pay-versus-performance table.
- The registrant may include non-financial performance measures in the tabular list only if (1) these measures are among the company’s three to seven most important performance measures, and (2) the registrant has also disclosed at least three (or fewer, if the registrant only uses fewer) financial performance measures in the list.

24. What are the registrant’s alternatives for disclosing the tabular list?

A registrant can disclose this tabular list in three different ways: (1) as one list; (2) as two separate lists, one for the CEO and one for the remaining NEOs; or (3) as separate lists for the CEO and each NEO. If the registrant elects to provide multiple lists, each list must include at least three (or fewer, if fewer than three are considered) and up to seven financial performance measures.

25. Is the registrant required to disclose the methodology used to calculate the performance measures included in the tabular list?

No. However, the SEC’s adopting release provides that registrants should consider supplemental disclosure if it would be helpful to investors to understand the measures, or necessary to prevent the tabular list from being confusing or misleading.
OTHER

26. What are the inline XBRL tagging requirements for the new pay-versus-performance disclosures?

Registrants must separately tag each value disclosed in the pay-versus-performance table, block-text tag the footnote, relationship and tabular list disclosure and tag specific data points (such as quantitative amounts) within the footnote disclosures, all in Inline XBRL.

27. What are the disclosure requirements for smaller reporting companies?

Smaller reporting companies must include the pay-versus-performance tabular and narrative or graphical disclosure for only the three most recently completed years, beginning with only two years in the first filing after the rules become effective. Smaller reporting companies are also not required to disclose (1) amounts relating to pensions for purposes of calculating executive compensation actually paid, (2) peer-group TSR, (3) a company-selected measure or (4) the tabular list of performance measures discussed above. Disclosure in the prescribed table in XBRL format is required by smaller reporting companies beginning in the third filing in which it provides this disclosure.

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