# SEC Issues Interpretive Guidance on Pay-versus-Performance Disclosures

**February 13, 2023**

On February 10, 2023, the Securities and Exchange Commission (the "SEC") published interpretive guidance on the new pay-versus-performance disclosures in the form of fifteen new Compliance & Disclosure Interpretations ("C&DIs") on Item 402(v) of Regulation S-K. The SEC's guidance comes at a time when most issuers are close to finalizing their pay-versus-performance disclosures, and even after some issuers have already filed their annual proxy statements including this disclosure. This Debevoise Update provides an overview of the SEC's new interpretive guidance. Our prior Debevoise in Depth provides detailed Q&As on the final pay-versus-performance disclosure rules.

## COMPANY-SELECTED MEASURE

The SEC provided the following guidance on the "company-selected measure" in the pay-versus-performance table, which is a financial performance measure that in the issuer's assessment represents the most important measure used to link compensation actually paid to the named executive officers ("NEOs"), for the most recently completed fiscal year, to company performance (other than TSR and net income, which are already reported in the table):

- The company-selected measure can be any financial performance measure that differs from TSR and net income, which includes **a measure that is derived from, a component of, or similar to TSR or net income**. (C&DI 128D.09)
- If the only impact of **stock price** on an NEO's compensation is through changes in the value of share-based awards, then stock price cannot be the issuer's company-selected measure. However, if, for example, the issuer's stock price is a market condition applicable to an incentive plan award, or is used to determine the size of a bonus pool, then stock price may be included as the issuer's company-selected measure. (C&DI 128.10)

- The company-selected measure **may not 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 in the table. (C&DI 128D.11)

- If an issuer uses a **bonus pool to determine annual bonus awards based on achievement of a financial performance measure**, even if bonus payments are discretionarily allocated from such pool, then the issuer is considered to be using the financial performance measure to link compensation actually paid to company performance. If this is the only such financial performance measure, then it would be the company-selected measure and set forth on the tabular list. (C&DI 128.12)

## TSR AND PEER GROUP TSR

The pay-versus-performance table includes cumulative Total Shareholder Return ("TSR") for the issuer and for a peer group, which can be (1) the same peer group included in the stock performance graph in the issuer's annual report under Item 201(e) of Regulation S-K or (2) a peer group used in the Compensation Discussion & Analysis ("CD&A") for purposes of disclosing the issuer's benchmarking practices. The SEC issued the following guidance on TSR and peer group TSR:

- For an **issuer that became public** during the earliest year included in the pay-versus-performance table, the "measurement" point for purposes of calculating TSR and peer group TSR should begin on the IPO registration date, consistent with the calculation of TSR under Item 201(e). (C&DI 128D.06)

- The issuer may use a **compensation peer group** that is disclosed in the CD&A as a peer group actually used by the issuer to help determine executive pay, even if such peer group is not used for "benchmarking" under Item 402(v)(2)(xiv) of Regulation S-K. (C&DI 128D.05)

- For the initial pay-versus-performance disclosure in the 2023 proxy, if an issuer has **changed its compensation peer group** during the prior three years, then the issuer should present the peer group TSR for each year in the pay-versus-performance table using the peer group disclosed in the issuer's CD&A for such year. (C&DI 128.07)

## GAAP NET INCOME

The SEC clarified that the "net income" metric that must be disclosed in the pay-versus-performance table means **GAAP net income** and not other net income amounts presented in the audited financial statements. (C&DI 128D.08)

## COMPENSATION ACTUALLY PAID

For a given year in the pay-versus-performance table, to calculate "compensation actually paid" for the CEO and other NEOs on average, the SEC's rules require the issuer to start with the total compensation as reported in the summary compensation table and then make the required adjustments for pension benefits and equity awards. The SEC's C&DIs addressed the following questions on calculating compensation actually paid and the related footnotes:

- With respect to a **new NEO** of the issuer, the calculation of compensation actually paid will include the change in value of all equity awards held during the executive's tenure as NEO, even if granted in a year prior to their appointment as NEO. (C&DI 128D.02)
- The **footnote disclosure** pursuant to Item 402(v)(3) is only required for the most recent fiscal year (unless it is material to an understanding of the pay-versus-performance table or relationship disclosure for the most recent fiscal year). However, in the issuer's first year of disclosure, the issuer should provide footnotes for each of the three years in the table. (C&DI 128D.03)
- In addition, with respect to the **level of detail required in the footnote disclosure**, an issuer must provide footnote disclosure of each of the amounts deducted and added to compensation actually paid pursuant to the pension benefit adjustment in Items 402(v)(2)(iii)(B)(1)(i)-(ii) and the equity award adjustment in Items 402(v)(2)(iii)(C)(1)(i)-(vi). Aggregate disclosure of pension value adjustments and equity award adjustments is insufficient. (C&DI 128D.04)

## OTHER INTERPRETIVE GUIDANCE

The SEC confirmed that the pay-versus-performance disclosure is **not required in an issuer's Form 10-K**, only in a proxy or information statement for which the SEC's rules require executive compensation disclosure. (C&DI 128D.01)

If an issuer has **multiple CEOs** in a fiscal year, the pay-versus-performance table must include separate columns for the compensation actually paid to each CEO. However, an issuer may **aggregate the CEOs' compensation** for purposes of the relationship disclosures to the extent that the presentation will not be misleading to investors. (C&DI 128D.13)

Finally, the C&DIs also provide guidance for issuers that **change their fiscal year**, or begin trading a new class of stock following **emergence from bankruptcy**, during the time period covered by the pay-versus-performance table. (See C&DI 228D.01 and C&DI 228D.02 for additional information.)

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Please do not hesitate to contact us with any questions.

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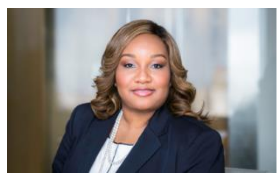

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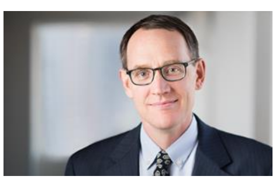

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