

After more than 12 years of development, on August 25, 2022, the Securities and Exchange Commission (“SEC”) adopted final rules to require that registrants disclose information on executive pay in comparison to the registrants’ financial performance, as required under Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).¹ The SEC originally proposed pay versus performance disclosure rules in 2015, and reopened the comment period on the 2015 proposal in January of this year.

The final rules, implemented through the addition of a new part (v) to Item 402 of Regulation S-K, require most registrants (except foreign private issuers, registered investment companies, and emerging growth companies) to include pay-versus-performance disclosures in any proxy or information statement in which executive compensation disclosures under Item 402 of Regulation S-K are also required. Smaller reporting companies (“SRCs”) benefit from scaled disclosure requirements.

The final rules become effective 30 days after publication in the Federal Register.

Required Disclosures

The final rules require covered registrants to disclose the following data in tabular format:

- The total compensation of the principal executive officer as reported in the summary compensation table and the average of the summary compensation table total compensation of the other named executive officers.
- The compensation “actually paid” to the principal executive officer and the average of the compensation “actually paid” to the other named executive officers.
- The registrant’s total shareholder return (“TSR”) and the TSR of the registrant’s peer group (weighted by market capitalization), using the definition of TSR from Item 201(e) of Regulation S-K (which requires inclusion of a shareholder return graph in the annual report), and using either the Item 201(e) peer group or the peer group reported in the company’s compensation discussion and analysis (“CD&A”) for peer group TSR.
- The registrant’s net income.
- A financial performance measure chosen by and specific to the registrant (the “Company-Selected Measure”) that, in the registrant’s determination, reflects the “most important” financial performance measure used by the registrant to link compensation “actually paid” to the registrant’s principal executive officer and named executive officers to company performance.

The tabular disclosures must be provided for the registrant’s most recently completed fiscal year, and the four preceding fiscal years. The disclosure will be phased in, so that disclosure for the first reporting year will cover three fiscal years, disclosure for the second reporting year will cover four fiscal years, and from the third reporting year and after, five fiscal years.

Additionally, registrants will be required to provide a clear description (which may be in narrative or graphic format, or a combination thereof) of the relationship between executive compensation “actually paid” and each of the financial performance measures included in the table, as well as a description of the relationship between the registrant’s TSR and its peer group’s TSR. These descriptions must cover the same periods as the tabular disclosures.

Registrants are also required to provide an unranked list of three to seven of the most important performance measures (which may include non-financial measures) used by the registrant to link compensation “actually paid” to the registrant’s overall performance for the last fiscal year (which must include the Company-Selected Measure provided in the tabular disclosure).

All of these disclosures are subject to Inline XBRL tagging.

SRCs are exempted from providing tabular disclosure of peer group TSR and the Company-Selected Measure, and will not need to provide any description regarding the link between compensation “actually paid” and peer group TSR or the Company-Selected Measure. They may also exclude the unranked list of financial performance measures. Pay-versus-performance disclosures for SRCs are limited to three fiscal years, beginning with a two fiscal year disclosure for the first reporting year, and they will have until their third reporting year to comply with Inline XBRL tagging requirements.

While the new pay-versus-performance disclosures are required to appear in the proxy or information statement, the final rules do not require that the disclosures appear in the CD&A. According to the SEC, this will allow registrants to avoid an implication that the registrant’s compensation committee considered the particular pay-versus-performance formulation defined in Item 402(v) when making compensation decisions.

¹ SEC Adopting Release, Pay Versus Performance (August 25, 2022), available at: <https://www.sec.gov/rules/final/2022/34-95607.pdf>

Compensation “Actually Paid”

The final rules require that, in addition to disclosing total compensation as reported in the summary compensation table, the registrant must report a different measure of compensation, compensation “actually paid,” for the principle executive officer and the average compensation “actually paid” for the other named executive officers.

In a notable change from the SEC’s 2015 proposing release, the final rules modify the definition of compensation “actually paid” from a “realized pay” methodology (which attempts to approximate the executive’s “cash in pocket”) to a “realizable pay” methodology. “Realizable pay” is frequently championed by independent compensation consultants as a more complete compensation measure for executives, as the methodology attempts to provide a “total picture” of the value of an executive’s paid and then-outstanding compensation as of a fiscal-year end, as well as the compensatory impact of certain benefits changes that occurred during the year.

An executive’s compensation “actually paid” under the final rules is defined to include the executive’s base salary, the earned value of cash incentives, the fair value of equity granted during the fiscal year, and the amount of change in fair value from the prior year of any equity awards that were outstanding or that vested during the fiscal year. It also includes above-market or preferential earnings on deferred compensation that is not tax qualified. With respect to changes in the actuarial present value of defined benefit plans, compensation “actually paid” must also include actuarially-determined “service cost” for services rendered by the executive during the fiscal year and the entire cost of benefits granted under a plan amendment during the fiscal year that are attributable to services rendered by the executive in periods before the plan amendment.

Conclusions and Next Steps

There appears to be some likelihood for legal challenges to the final rules, given the divided 3-2 approval of the final rules and the positions laid out by Commissioners Peirce² and Uyeda³ concerning the final rules’ costs and whether the SEC had fully complied with the Administrative Procedures Act in adopting a seemingly dormant rule proposal after a limited reopening of a comment period for the 2015 proposal.

However, assuming there are no successful challenges that delay implementation, registrants will be required to include these new disclosures in proxy or information statements relating to fiscal years ending on or after December 16, 2022.

This means that December 31 fiscal year end reporting companies will need to develop these disclosures for the 2023 proxy season.

Given the relatively short timeframe for compliance, compensation committees and their independent compensation consultants should begin evaluating the new rules, working through the new disclosure requirements, and considering how the disclosures may impact compensation-related approvals, as soon as possible in preparation for the 2023 proxy season.

Registrants who have never before included pay-versus-performance disclosure in their proxy statement will need to quickly evaluate the availability of the data needed to satisfy the final rules’ disclosure requirements, but will also need to evaluate whether the final rules’ prescriptive pay-for-performance disclosures should be further supplemented with more tailored disclosure to ensure investors receive a better, more complete, and more relevant picture of executive compensation and performance.

Those registrants who have regularly included customized pay-versus-performance disclosures, which have become a trend among issuers since the Dodd-Frank Act became law, must now determine whether and how to modify the customized pay-versus-performance disclosures – which their investors have become acclimated to and may now rely upon – to coordinate with the final rules’ more prescriptive approach.

If you need assistance navigating these new disclosure rules, please contact your primary Squire Patton Boggs’ counsel, or one of the contacts listed below.

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2 Neither Pay nor Performance, Commissioner Hester M. Peirce (August 25, 2022) available at: <https://www.sec.gov/news/statement/peirce-statement-pay-vs-performance-082522>

3 Statement on the Final Rule Related to Pay Versus Performance, Commissioner Mark T. Uyeda (August 25, 2022) available at: <https://www.sec.gov/news/statement/uyeda-statement-final-rule-related-pay-versus-performance-082522>