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EXEQUITY

Independent Board and Management Advisors

*Client Alert*

# SEC Issues C&DIs Covering New Pay Versus Performance Disclosures

On February 10, 2023, the SEC posted new compliance and disclosure interpretations (C&DIs) covering the new pay versus performance (PVP) disclosures.[1]

## New C&DIs

The new C&DIs are mixed in with all of the other C&DIs covering Regulation S-K. The easiest way to locate the new C&DIs is to search for "February 10, 2023" in your web browser.

The new C&DIs provide the following interpretations from the SEC:

- The PVP disclosures required by Item 402(v) of Regulation S-K do not need to be included in a Form 10-K. Q.128D.01
- For new named executive officers (NEOs), companies must include equity awards that were granted to him/her prior to the year becoming an NEO when calculating "compensation actually paid" (CAP). Q.128D.02
- Companies must provide footnote disclosure for amounts deducted and added to total compensation in the Summary Compensation Table (SCT) pursuant to Item 402(v)(2)(iii) for the last fiscal year. But, for the first PVP disclosure, companies must include such a footnote for every year presented. Q.128D.03
- Companies cannot aggregate the amounts deducted and added pursuant to Item 402(v)(2)(iii) and must separately detail each such addition and subtraction. Q.128D.04

***Exequity Comment:*** *While companies cannot show the additions and deductions as aggregate amounts in the footnotes to the PVP table, this C&DI requires companies to aggregate the amounts shown by category of addition and deduction for both pension amounts and equity awards, e.g., for equity awards: add the fair value of awards granted during the year that are outstanding and unvested as of FYE, add the change in fair value of outstanding and unvested awards from prior FYE, add the fair value as of the vesting date of awards that were granted and vested in the same year, add the change in fair value of awards that vested during the fiscal year from the prior FYE, subtract the fair value as of the prior FYE for awards that did not vest, and add the*

[1] See SEC's C&DIs posted February 10, 2023 for Regulation S-K at: https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.

*amount of dividends or other earnings paid on stock or option awards prior to vesting that are not otherwise included in total compensation for that year.*

*In addition to the additions and subtractions by each category called for by the above C&DI, companies should also show in their footnotes to the PVP table the amounts shown in the SCT columns that were deducted from the SCT total to arrive at CAP, i.e., the aggregate change in the actuarial present value of the NEO's accumulated benefit under all defined benefit and actuarial pension plans, and the amounts reported in the SCT as stock awards and option awards. Many companies no longer maintain pension plans for executives and therefore show nothing in the column associated with changes in the aggregate change in the actuarial present value of the NEO's accumulated benefit under all defined benefit and actuarial pension plans.*

*Companies could provide a reconciliation between the SCT Total and CAP amounts:*

| *PEO* | *Reported SCT Total Compensation* | *Subtract Reported SCT Stock Awards Value* | *Subtract Reported SCT Option Awards Value* | *Total Equity Award Adjustments* | *Compensation Actually Paid Amount* |
|---|---|---|---|---|---|
| *2022* | *$* | *$* | *$* | *$* | *$* |
| *2021* | *$* | *$* | *$* | *$* | *$* |
| *2020* | *$* | *$* | *$* | *$* | *$* |

*Most companies do not grant equity awards that are vested or vest during the year of grant, so that column in the table below could be left out since not applicable. Such companies would only need to concern themselves with the footnotes with respect to the other categories for equity awards. Below is a sample table that could be used for disclosing the necessary information for the PEO and the Other NEOs (though for the Other NEOs the headings should clarify that it is the Average for each column) showing the Equity Award Adjustments:*

| *PEO* | *Add FYE fair value of outstanding and unvested awards granted during the FY* | *Add Change in Fair Value of outstanding and unvested awards at FYE from prior FYE* | *Add the Fair Value of Awards as of the vesting date that were granted and vested during the FY* | *Add the Change in Fair Value of awards that vested during the FY from the prior FYE* | *Subtract the fair value as of the prior FYE for awards that did not vest* | *Add the amount of dividend or other earnings paid on stock or option awards prior to vesting that are not otherwise included in total compensation for the FY* | *Total Equity Award Adjustments* |
|---|---|---|---|---|---|---|---|
| *2022* | *$* | *$* | *$* | *$* | *$* | *$* | *$* |
| *2021* | *$* | *$* | *$* | *$* | *$* | *$* | *$* |
| *2020* | *$* | *$* | *$* | *$* | *$* | *$* | *$* |

- Companies can select a compensation peer group disclosed in the Compensation Discussion and Analysis (CD&A) even if it was not used for “benchmarking” so long as it was used to help determine executive pay. Q.128D.05
- For companies that have gone public during the earliest year included in the PVP table, if the class of securities was registered under Section 12 of the Exchange Act, the “measurement period” for purposes of calculating total shareholder return (TSR) and peer group TSR begins on such registration date. This is consistent with the calculation of TSR under Item 201(e) of Regulation S-K (5-year performance graph disclosed in the 10-K). Q.128D.06
- If a company selects to use its compensation peer group disclosed in the CD&A, and such compensation peer group was the same in 2020 and 2021 but changed for 2022, a company cannot present the peer group TSR for each of the three years using the 2022 peer group, and instead should present the TSR for each year in the PVP table using the peer group disclosed in the CD&A for such year. Q.128D.07
- Companies must disclose net income or loss as required by Regulation S-X to be disclosed in its audited GAAP financial statements in the PVP table and cannot use other net income amounts. Q.128D.08
- The Company-Selected Measure can be any financial performance measure that differs from the financial performance measures otherwise required to be disclosed in the PVP table, including a measure that is derived from, or a component of the required measures. For example, a company could use earnings per share, gross profit, income or loss from continuing operations, or relative TSR as its Company-Selected Measure. Q.128D.09
- If a company does not use any financial measures to link pay and financial performance, even if the compensation actually paid includes the fair value of time-vested share-based awards, they cannot use stock price as the Company-Selected Measure if it is not otherwise used to link compensation actually paid to company performance, for example, if stock price is a market condition applicable to an incentive plan award, or is used to determine the size of a bonus pool. Q.128D.10
- The Company-Selected Measure cannot be a multi-period that includes the applicable fiscal year as the final year, e.g., 3-year Relative TSR. The Company-Selected Measure represents the most important financial performance measure (not otherwise disclosed in the PVP table) used by the company to link compensation actually paid to the company’s NEOs for the most recently completed fiscal year to company performance. Q.128D.11
- If a company has a “pool plan” to determine its annual bonus awards where it is only available for payout upon achievement of a financial performance measure or the size of the pool is determined based upon the extent such measure is achieved, but then the compensation committee allocates bonus payouts in its discretion, independent of any financial performance measures, a company may not omit the Tabular List of financial performance measures, the Company-Selected Measure in the PVP table and the relationship disclosures between compensation actually paid and the Company-Selected Measure. Q.128D.12
- If a company has multiple PEOs in a fiscal year, a company can aggregate the PEOs’ compensation for purposes of the narrative, graphical, or combined comparison between compensation actually paid and

TSR, net income, and the Company-Selected Measure if it would not be misleading to investors. But, the company still needs to provide separate columns for each PEO in the PVP table. Q.128D.13

- If a company changes its fiscal year, then it should provide the PVP disclosure for the stub period, and should not annualize or restate compensation. 228D.01
- If a company emerges from bankruptcy during the period covered by the PVP disclosure, it only has to provide the company and peer group TSR from the date it emerged from bankruptcy and began trading and also provide a footnote to the PVP table to explain the approach taken and its effect. 228D.02

## Unanswered Questions

While the new C&DIs are helpful as far as they go, they did not address all the questions we have seen companies have to confront in the context of the new PVP disclosures. For example, for newly public companies, we now know that for purposes of TSR, the measurement starts on the date of registration. But what about the calculation of an NEOs' compensation actually paid? Do equity awards' values start to be measured on that same date or must a company try and use pre-public valuations? Also, what should a company that is spun-off from a public company do? Likely the TSR guidance would apply, but what should such a company do in determining compensation actually paid to NEOs with respect to parent company awards granted prior to the spin-off?

## Next Steps

Companies should review any draft PVP disclosures they have already prepared in light of these new C&DIs. The one that might cause some revision of footnotes to the PVP table is Q.128D.04 which indicates that the additions and deductions to the SCT Total amounts to arrive at the compensation actually paid cannot be provided on an aggregate basis and must be detailed separately.

If you have any questions about this ***Client Alert***, please contact Ed Hauder ((847) 996-3990 or Edward.Hauder@exqty.com or any of the following:


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