LEGAL UPDATES

PUBLISHED: SEPTEMBER 7, 2022

The SEC's Long-Delayed Dodd-Frank Pay-Versus-Performance Disclosure Requirements Have Finally Arrived

Service

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On August 25, 2022, the Securities and Exchange Commission (SEC) adopted the pay-versus-performance disclosure requirements that had been in the works for years. The SEC originally proposed pay versus performance rules pursuant to the requirements of Section 14(i) of Securities Exchange Act of 1934 (added by Section 953(a) of the Dodd-Frank Act) in 2015, but nothing was adopted at the time. In January of this year, the SEC reopened the comment period on its proposed rules, followed by adoption of the rules at the end of August with certain changes in response to both rounds of comments received on the original proposal.

The SEC elected not to provide the one-year, phase-in period that has accompanied most major new disclosure requirements in recent years. Instead, beginning with proxy and information statements required to include executive compensation disclosures for fiscal years ending on or after December 16, 2022 (i.e., the 2023 proxy season for most issuers), public companies will be required to include additional disclosures showing the relationship between executive compensation actually paid and the company's financial performance, as further detailed below. These new disclosures will be treated as "filed" information under the Exchange Act, and also will be subject to the advisory "say-on-pay" votes by company shareholders required under Exchange Act Rule 14a-21.

Specifically, new Item 402(v) of Regulation S-K will require registrants to disclose, in the tabular format rendered below, the following Compensation and Performance Measures.

Compensation measures

Total compensation (as calculated in the Summary Compensation Table) for the principal executive officer (PEO) and, as an average, for the other named executive officers (NEOs)

The compensation "actually paid" to the PEO and, as an average, for the other NEOs, which is to be derived by adjusting Total Compensation as reported in the Summary Compensation Table as follows (with prescribed footnote disclosure related to such adjustments):
deduct the total aggregate change in the actuarial present value of all defined benefit and actuarial pension plans (as reported in Column (h) of the Summary Compensation Table) and add both (i) the actuarially determined service cost for services rendered by the executive during the applicable year and (ii) the "prior service cost" for benefits granted under any new plans or plan amendments during the applicable year that are attributed to services rendered in prior periods (or subtract such cost for a plan amendment that reduces benefits), each calculated in accordance with US GAAP, and
deduct the grant date fair value of equity awards (as reported in Columns (e) and (f) of the Summary Compensation Table) and instead add amounts calculated to reflect year-end or year-over-year changes in fair value (calculated in accordance with US GAAP), as follows:

- For awards granted in the covered year, add either the year-end fair value for awards that remain outstanding at year-end or the vesting date fair value for awards that vested during the year;
- For awards granted in prior years (i) add or subtract changes in fair value as of the end of the covered year comparted to fair value at the end of the prior year for awards that remain outstanding at year-end, (ii) add or subtract changes in fair value as of the vesting date (as compared to the end of the prior year) for awards that vested during the year and (iii) subtract the fair value (as of the end of the prior year) for any award that was forfeited during the year; and
- Add the dollar value of any dividends or other earnings paid during the year (prior to any applicable vesting date) on stock awards or options, to the extent such amounts are not otherwise reflected in the fair value of such awards or otherwise already included in Total Compensation.

Performance measures

Cumulative annual total shareholder return (TSR) for the company, calculated and presented in the same manner as the Stock Performance Graph required by Item 201(e) of SEC Regulation S-K (changes in the dollar value of an initial investment of $100)

Cumulative annual TSR for the company's peer group

The peer group used here must be either the peer group used by the company for purposes of its Item 201(e) performance graph or a peer group referenced in the company's Compensation Discussion and Analysis used for compensation benchmarking purposes

The company's GAAP net income

An amount attributable to a financial performance measure chosen by and specific to the company (the Company-Selected Measure)

This measure must be selected by the company from the Tabular List (as described below) and should represent the most important financial measure, not otherwise presented in the table, used by the company to link compensation actually paid to company performance for its most recently completed fiscal year (accompanied, in the case of a non-GAAP financial measure, by disclosure of how such measure is calculated from the company's audited financial statements but not by a full reconciliation – i.e., the same disclosure required when non-GAAP metrics are used in the proxy statement's Compensation Discussion and Analysis (CD&A) section).

Tabular format compensation and performance measures

Year	Summary Compensation Table Total for PEO	Compensation Actually Paid to PEO	Average Summary Compensation Table Total for Non-PEO NEOs	Average Compensation Actually Paid to Non-PEO NEOs	Value of Initial Fixed $100 Investment Based on:		Net Income	Company-Selected Measure **
					Total Shareholder Return	Peer Group Total Shareholder Return*		
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
Y1								
Y2								
Y3								

Y4*								
Y5*								

* Indicates portions of the disclosure from which Smaller Reporting Companies (SRCs) are exempt.

** A company does not need to include a Company-Selected Measure if the company does not use any additional financial performance measures or only uses measures already required by the table

Description required to accompany tabular disclosures

In addition to the tabular disclosure described above, companies must include a "clear description" in narrative or graphic description, or a combination of both, of:

the relationship between each financial performance measure included in the table and the executive compensation "actually paid" (both to the PEO and the average for the other NEOs) over the fiscal years required to be disclosed; and

the relationship between the company's TSR and its peer group TSR as reflected in the table.

The SEC encourages companies to present these relationships in a format that most clearly provides information to investors, based on the nature of each measure. Further, if a company chooses to include any additional, voluntary performance measures in the table beyond those required (as permitted but not required by the rules), the company must include similar disclosure of the relationship between such measure and the compensation "actually paid" to its PEO and the average for the other NEOs.

Tabular list of additional performance measures

Companies also will be required to provide a Tabular List of at least three and up to seven financial performance measures that the company determines are its most important measures used to link executive compensation "actually paid" (as presented in the table described above) for the most recently completed fiscal year to performance. Companies may also include nonfinancial measures (such as ESG goals or other non-financial objectives) if they are considered most important, so long as at least three of the measures are financial performance measures and the total number of performance measures (both financial and nonfinancial) does not exceed seven. If a company uses fewer than three financial performance measures to link compensation to performance, the table must list all such measures.

XBRL tagging requirements

Companies will be required to use Inline XBRL to tag the tabular values in their pay versus performance disclosure. Block-text tagging will also be required for the descriptive material concerning the relationship between compensation “actually paid” and the prescribed performance metrics and for required footnote disclosures, with certain data points in the footnotes also subject to tagging.

Issuers affected and transition considerations

These new rules will affect most public companies, including smaller reporting companies. As reflected in the table above, smaller reporting companies are subject to scaled disclosure requirements that will allow them to omit Peer Group TSR and the Company Selected Measure from their disclosures. Additionally:

Under transition provisions, non-SRCs will be required to provide disclosure in their first covered proxy or information statement only for their most recently completed fiscal year and the two prior years, with one additional year of disclosure being added to the table in each of the next two years’ filings.

SRCs will only be required to disclose information for three instead of five years, with transition provisions allowing them to include disclosure for their most recently completed fiscal year and the preceding year in their first covered proxy or information statement, with a third year to be added in the following year’s filing; and

These disclosures will not be required for emerging growth companies, foreign private issuers, or registered investment companies.

What this means to you

Covered public companies should begin their preparations for compliance with these new rules immediately. Many companies – particularly smaller issuers – may require significant assistance from their compensation consultants and other advisors with assembling the information and performing the calculations required for compliance (including implementation of any related enhancements to their disclosure controls and procedures). Evaluation of the initial data and the relationship between these mandated performance measures and the SEC’s new and unfamiliar definition of compensation “actually paid” must be completed in ample time to facilitate preparation of the related description. The prescriptive and backward-looking nature of these disclosures – in contrast to the CD&A’s more flexible, principles-based explanation of the Compensation Committee’s actual executive pay practices – may give rise to conflicts that could create significant investor confusion if they are not carefully addressed.

Contact us

Husch Blackwell's Securities & Corporate Governance team will continue to monitor these changes and their implications. Should you have any questions, please do not hesitate to contact Steve Barrett, Rebecca Taylor, Shari Wright, Shelby Moylan, Brian Wetzstein, or your Husch Blackwell attorney.