

SEC reopens comment period for “pay versus performance” disclosure rule

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The SEC proposes disclosure of additional metrics beyond total shareholder return (TSR) for this unfinished Dodd-Frank rulemaking.

On January 27, 2022, the Securities and Exchange Commission [announced](#) that it is reopening the comment period for its [proposed pay versus performance disclosure rule](#), which has languished ever since Congress directed the SEC to adopt it in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Dodd-Frank directed the SEC to implement rules requiring public companies to disclose, in any proxy or information statement, a clear description of the relationship between compensation actually paid to the company’s named executive officers (NEOs) and the financial performance of the company.

The SEC’s [original proposal in 2015](#), described further below¹, would have required new tabular disclosure covering a period of up to five years focused largely on the relationship between the compensation “actually paid” to NEOs and cumulative total shareholder return (TSR). The SEC is now proposing to broaden the rule to require tabular disclosure of three additional metrics alongside TSR: pre-tax net income, net income and a “company-selected measure”, as follows:

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	Total Shareholder Return	Peer Group Total Shareholder Return*	Pre-Tax Net Income (Loss)	Net Income (Loss)	[Company-Selected Measure]*
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
Y1									
Y2									
Y3									
Y4*									
Y5*									

* Smaller reporting companies (SRCs) would be exempt from the items marked with an asterisk.

The “company-selected measure” would be a performance measure chosen by management that the company believes represents the “most important” performance measure used by the company (that is not already included in the table) to align compensation actually paid with company performance. The SEC has asked for input on how to define “importance” in the context of the company-selected measure and the form of disclosure.

Further, the SEC has asked for input on whether to require disclosure (as shown below) of the company's top five most important performance measures, instead of just one. If the company considers fewer than five performance measures in determining NEO compensation, then disclosure would be limited to the lesser number of measures actually considered.

	Five Most Important Company Performance Measures for Determining NEO compensation
1.	Measure 1
2.	Measure 2
3.	Measure 3
4.	Measure 4
5.	Measure 5

The proposed additional metrics mark a meaningful expansion of the SEC's 2015 proposed rule, and would significantly increase the complexity and cost of disclosure by requiring companies to assign rankings to their performance measures—something that is not currently a widespread practice. Furthermore, while Chair Gensler has stated that the additional information required by the proposed rule would “strengthen the transparency and quality of executive compensation disclosure”, it is not clear that institutional investors have, as a general matter, been requesting this additional information. Such detailed standardized disclosure would also mark a significant departure from the SEC's existing principles-based approach, which encourages companies to provide bespoke disclosure in the CD&A explaining the rationale and impact of the company's compensation program.

Additional topics that the SEC could include in the final rules, as reflected in their requests for comment, include:

- How companies should present the newly required disclosure when different measures are important in different years or when different measures apply to different NEOs;
- Whether to explicitly require disclosure of *all* of the performance measures that actually determine NEO compensation and the need for improvements for such disclosure already being provided;
- Whether companies should be required to limit their company-selected measures to financial performance measures or whether they should be permitted to select any measure used to determine compensation actually paid (including environmental, social and governance-related measures);
- Whether the definition of compensation “actually paid” addresses any misalignment between the time period to which compensation is attributed and the time period associated with the disclosed performance measures;
- The time periods used for TSR (e.g., a five-year cumulative and rolling average, a cumulative average within the five-year period covered by the table, an annual year-over-year figure or some other time period);
- Whether there are any viable alternatives to computing the fair value of options at the vesting date instead of the grant date;
- Whether there is a better alternative measure than pension service cost to determine amounts attributable to pension plans required to be disclosed as compensation actually paid; and
- Whether specific data points in the footnotes to the table should be required to be XBRL tagged (in addition to the XBRL tagging required for information included in the table itself).

The 2015 proposal

The SEC's 2015 proposed rule included the following elements, all of which are generally retained by the current proposed rule.

- A new table, covering up to five years, would be required that shows:

- Compensation actually paid to the CEO, and the total compensation paid to the CEO as reported in the Summary Compensation Table;
 - Average compensation actually paid to other NEOs, and average compensation paid to such officers as reported in the Summary Compensation Table; and
 - Cumulative TSR of the company and a company-selected peer group.
- Disclosure would be required of the relationship between:
 - Executive compensation actually paid and company TSR; and
 - Company TSR and peer group TSR.
 - Emerging growth companies, foreign private issuers, and registered investment companies would be exempted.
 - After a transition period, companies other than SRCs would have to provide the required disclosure for five years, and SRCs for three years.
 - The amount of compensation actually paid for a fiscal year would equal the amount reported in the “Total” column of the Summary Compensation Table for such fiscal year, and then adjust for equity awards that vested and the service cost relating to pension benefits.
 - The amount of compensation actually paid and the cumulative TSR of the company and its peers would have to be presented in tabular format. The relationship between pay and performance may be presented graphically and/or narratively; the company must clearly describe the relationship between (1) executive compensation actually paid and company TSR and (2) company TSR and peer group TSR.
 - The disclosure must be electronically formatted using XBRL.

[Commenters](#) in 2015 observed that the proposed rule was more prescriptive and expansive than required under the Dodd-Frank Act, noting some key concerns relating to the proposed rule, including that it would:

- Go beyond congressional intent in mandating the use of TSR as the exclusive measure of performance, and registrants should be permitted to disclose additional measures of performance;
- Require the disclosure of the relationship between the company’s TSR and its peer group, which could prove misleading in light of peer group selection methodologies and the potential resultant discrepancy between the company and its peer group in size and industry;
- Include a five-year disclosure period, which should be shortened either to one year (in alignment with the applicable period for the say-on-pay vote), or to three years (in alignment with the Summary Compensation Table);
- Require disclosure for all NEOs, when investors are primarily concerned with the CEO’s compensation; and
- Introduce a new definition of “actually paid” compensation, which is different from “total” compensation that is used for purposes of the Summary Compensation Table and could be confusing to investors.

Next steps

The comment period will be open for 30 days after the SEC’s release is published in the Federal Register, which has not yet occurred as of the date of this update. The SEC will then review and consider comments before publishing a final rule.

Under the 2015 proposed rule, the pay versus performance disclosure would have been required in the first proxy or information statement filed after the final rule became effective. If the same timing were to apply at this time, then, if the rule is finalized in 2022, calendar year companies would be required to provide this disclosure as early as the 2023 proxy season.

Given the SEC’s renewed interest in finalizing its pay versus performance disclosure rule, companies may wish to consider taking the following actions as we move toward final SEC rulemaking:

- Inform their boards or the relevant committee(s) of the reopening of the comment period for the proposed rule and the potential impact of the proposed rule on the company’s incentive compensation program, especially when executives are remunerated using different metrics, or if companies seek to maintain flexibility over the use of different performance metrics over time;

- Model what the company’s disclosure might look like, both under the 2015 proposed rule, as well as if the SEC’s suggestions in connection with reopening the comment period are incorporated into the final rule;
- Identify which performance metrics the company uses in its incentive compensation program and consider whether any changes would be prudent as a result of the proposed rule—in this vein, companies should also coordinate with their investor relations teams to ensure that the selected metrics align with the company’s overall message to investors and to plan for earnings releases; and
- Consider commenting on the proposed rule, in particular, if the data requested by the SEC can be provided.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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¹ For additional information on the proposed rule, see our [2015 client update](#) and our [2015 comment letter](#) submitted to the SEC.