

SEC adopts long-awaited final rule on “pay versus performance” disclosure

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The SEC adopted the final rule implementing the “pay versus performance” disclosure requirement mandated by the Dodd-Frank Act, which is broader in scope than the 2015 proposed rule and will apply for the 2023 annual meeting proxy statements for calendar-year companies.

More than 12 years after Congress first mandated the so-called “pay versus performance” disclosure requirement under the Dodd-Frank Act, on August 25, 2022, the SEC [announced](#) that it has adopted a [final rule](#) to implement that mandate.

The SEC initially released its [proposed rule](#) on “pay versus performance” disclosure in 2015 and, earlier this year, [reopened the comment period](#) on the proposed rule that included additional requirements not mandated by statute or in the 2015 proposal.¹

The adoption of the final “pay versus performance” rule marks another step in the SEC’s efforts to fulfill its remaining rulemaking responsibilities under Dodd-Frank. [The SEC has now also set the agenda](#) for upcoming regulatory actions, which indicates that the final rule on clawback policies mandated by Dodd-Frank will be issued in the coming months.

Overview of the final rule

The final rule adds new Item 402(v) to Regulation S-K and requires that a company (excluding any emerging growth company, foreign private issuer or registered investment company) provide, in its proxy or information statement:

- a new “pay versus performance” table, covering up to five years that shows:
 - compensation “actually paid” to the company’s principal executive officer (PEO), and total compensation paid to the PEO as reported in the Summary Compensation Table;
 - average compensation “actually paid” to the company’s other named executive officers (NEOs), and average compensation paid to such NEOs as reported in the Summary Compensation Table;
 - for each covered year: (i) cumulative total shareholder return (TSR) of the company, (ii) cumulative TSR of the company’s peer group, (iii) the company’s net income and (iv) an amount attributable to a “company-selected measure”;
- a description of the relationships between the performance measures included in the “pay versus performance” table and the compensation “actually paid” to the company’s PEO and other NEOs over all covered years, as well as the relationship between the company’s cumulative TSR and that of its peer group; and
- an unranked tabular list (the “Tabular List”) of three to seven of the “most important” financial performance measures used by the company to link compensation “actually paid” to the NEOs to company performance.

The final rule retained many of the same elements from the 2015 proposed rule, but expands the scope of the disclosure requirements beyond what was included in the proposed rule in certain key areas, including by:

- requiring disclosure of two additional financial performance metrics (net income and a “company-selected measure”) and the relationship of those metrics to compensation “actually paid” to a company’s NEOs;
- requiring tabular disclosure of the company’s “most important” performance measures for linking NEO pay to performance; and
- adopting a “mark-to-market” approach for valuing equity awards that deviates from long-standing principles used for reporting equity awards in the Summary Compensation Table.

For a more detailed comparison between the final rule and proposed rule, see the section below titled “Summary of the final rule and comparison to the proposed rule.”

Key Q&As

The Q&A below provides details on the key requirements under the final rule.

General

Q: When will pay versus performance disclosure first be required?

A: In the first proxy or information statement filed for fiscal years ending on or after December 16, 2022.

Calendar-year companies will be required to provide this disclosure in their proxy statement filed for the 2023 proxy season.

Q: Which filings must include pay versus performance disclosure?

A: Any proxy or information statement in which Item 402 compensation disclosure is required in conjunction with a shareholder vote.

Pay versus performance disclosure will be required in proxy statements for annual and special shareholder meetings filed on Schedule 14A and information statements filed on Schedule 14C. The disclosure is not required in Form S-1 registration statements or Form 10-K annual reports, regardless of whether such forms include Item 402 compensation disclosure, because the information is intended to be presented in conjunction with a shareholder vote.

The “pay versus performance” disclosure will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the company specifically incorporates it by reference.

Q: Which companies are subject to pay versus performance disclosure?

A: Companies that file proxy and information statements. However, the following types of companies are exempt from compliance with the final rule:

- emerging growth companies, or EGCs;²
- foreign private issuers (even those filing on U.S. periodic disclosure forms); and
- registered investment companies.

Small reporting companies (SRCs) are subject to the final rule, but with more scaled-down disclosure requirements that are phased in over time, as shown in the summary chart above and discussed further below.³

Q: Do any transition rules apply to newly public companies?

A: Yes. Pay versus performance disclosure is not required in an IPO filing. In addition, a newly public company that does not otherwise qualify for EGC relief need not provide disclosure for fiscal years prior to the fiscal year when the company became subject to the reporting requirements under Section 13(a) or 15(d) of the Exchange Act.

Example. A non-EGC company completes its IPO in 2022 and files its first annual proxy statement in 2023. The company was not an Exchange Act filer prior to 2022. The company is not required to provide pay versus performance disclosure in its IPO registration statement. In its 2023 proxy statement, the company is required to provide disclosure only for 2022. In its 2024 proxy statement, the company is required to provide disclosure only for 2022 and 2023.

Q: How must the disclosure be presented?

A: The “Pay Versus Performance” table that discloses specified NEO compensation amounts and financial performance measures must be presented in the following format:

Year (a)	Summary compensation table total for PEO (b)	Compensation actually paid to PEO (c)	Average summary compensation table total for non-PEO named executive officers (d)	Average compensation actually paid to non-PEO named executive officers (e)	Value of initial fixed \$100 investment based on:		Net income (h)	[Comp select measure?] (i)
					Total shareholder return (f)	Peer group total shareholder return* (g)		
Y1								
Y2								
Y3								
Y4*								
Y5*								

*The asterisked items indicate components of the table from which SRCs are exempt.

? The title of this column would be replaced with the name of the company’s “most important” measure, and that column would include the numerically quantifiable performance of the company under such measure for each covered fiscal year. For example, if the Company-Selected Measure for the most recent fiscal year was total revenue, the company would title the column “Total Revenue” and disclose its quantified total revenue performance in each covered fiscal year.

Q: Where must the disclosure be made?

A: Anywhere in the proxy or information statement.

Consistent with the proposed rule, the final rule gives companies flexibility in determining where in the proxy or information statement to provide the required disclosure, but requires that the disclosure be electronically formatted using Inline XBRL.

Many companies will likely decide to include the “pay versus performance” disclosure in or near the CD&A. As noted by the SEC, including the disclosure in the CD&A may cause confusion for investors as it may suggest that the company considered the pay versus performance relationship in its compensation decisions, which may not be the case.

Time periods covered

Q: For what period is pay versus performance disclosure required to be provided?

A: After a transition period, companies other than SRCs must provide the information for 5 years, and SRCs must provide the information for 3 years.

Companies are required to provide pay versus performance disclosure for the following number of years prior to the year in which the proxy or information statement is filed:

Year of filing	Companies generally	SRCs
First year	3 years	2 years
Second year	4 years	3 years
Third year and thereafter	5 years	3 years

This differs from the Summary Compensation Table disclosure, which requires reporting compensation for only three years (or two years, for SRCs).

Executives covered

Q: Whose compensation is covered?

A: The PEO individually, and the other NEOs as a group.

If more than one person served as PEO in any fiscal year, the Summary Compensation Table total compensation, as well as total compensation “actually paid” to *each* PEO, is required to be disclosed for *each* PEO during that fiscal year. This disclosure would be made by adding additional columns to the table for the additional PEOs.

Compensation for the other NEOs is required to be disclosed as an average, which the SEC indicates is because the numbers and identities of these officers can vary over the requisite period. This would include all principal financial officers (PFOs) for each year in which a company has more than one PFO. This would also include up to two additional individuals for each year who would have been one of the three named executive officers (other than the PEO and PFO) based on their total compensation reported in the Summary Compensation Table, if they were serving as executive officers at the end of such year (including any separation payments made to such additional individuals that were required to be disclosed under Item 402).

Companies are required to identify in footnote disclosure to the table the individual NEOs whose compensation amounts are included in the average for each year.

Compensation “actually paid”

Q: How is the amount of compensation “actually paid” determined?

A: The amount of compensation “actually paid” for a fiscal year equals the amount reported in the “Total” column of the Summary Compensation Table for such fiscal year, adjusted as described below. Adjustments with respect to pension plans will not apply to SRCs because, as noted below, they are not otherwise required to disclose executive compensation related to pension plans.

– Equity Awards:

- Subtract the grant date fair values of the equity awards reported in the “Stock Awards” and “Option Awards” columns of the Summary Compensation Table for the covered fiscal year;
- Add the fair values as of the end of the covered fiscal year of all equity awards granted during such fiscal year that are outstanding and unvested as of the end of such fiscal year;
- Add the change in fair value (whether positive or negative) as of the end of the covered fiscal year of any equity awards granted in any prior fiscal year that are outstanding and unvested as of the end of such fiscal year;
- Add, for awards that are granted and vest in the same fiscal year, the fair value as of the vesting date;
- Add the change in fair value (whether positive or negative) as of the vesting date of any awards granted in any prior fiscal year for which all applicable vesting conditions were satisfied at the end of or during the covered fiscal year;
- Subtract, for any awards granted in any prior fiscal year that fail to meet the applicable vesting conditions during the covered fiscal year, the fair value at the end of the prior fiscal year; and
- Add the dollar value of any dividends or other earnings paid on equity awards in the covered fiscal year prior to the vesting date that are not otherwise included in another component of total compensation for such fiscal year.⁴

“Fair value” must be computed in a manner consistent with FASB ASC Topic 718. The fair value determinations must also take into account any excess fair value (if any) as a result of any adjustments (including through amendment,

cancellation or replacement grants or other means) or other material modifications to awards made during the last completed fiscal year. Similar to disclosure in the Summary Compensation Table, the fair value of any awards subject to performance conditions must be based on the probable outcome of such conditions, but unlike the Summary Compensation Table, the determination of probable outcome must be made as of the last day of the fiscal year.

In addition, for compensation “actually paid” to the PEO and other NEOs, companies are required to include footnote disclosure detailing each of the amounts subtracted and added and include footnote disclosure if any assumption used for the fair value determination differs materially from the grant date assumptions used for the grant date valuations, as disclosed in the footnotes to the Summary Compensation Table.

– **Pension Benefits:**

- Subtract the aggregate change in the actuarial present value of the accumulated benefit under all defined benefit and actuarial pension plans reported in the “Change in Pension Value and Nonqualified Deferred Compensation Earnings” column of the Summary Compensation Table for such covered fiscal year; and
- Add the following:
 - the “**service cost**,” calculated as the actuarial present value of the executive’s benefit under all such plans attributable to services rendered during the covered fiscal year; and
 - the “**prior service cost**,” calculated as the entire cost of benefits granted (or credit for benefits reduced) in a plan amendment (or initiation) during the covered fiscal year that are attributed by the benefit formula to services rendered in periods prior to the amendment (calculated consistent with how “service cost” is defined in FASB ASC Topic 715).

Example. For 2022, the compensation reported for a company’s PEO in the Summary Compensation Table totals \$2,200,000, consisting of \$500,000 in salary, \$500,000 in annual cash bonus, \$900,000 in equity awards granted in 2022 (of which 1/3 (\$300,000) vested in 2022), \$200,000 in change in pension value and \$100,000 in all other compensation. In addition, the PEO was awarded \$600,000 in equity awards in 2021, of which 1/3 vested in 2021 and 1/3 vested in 2022 and the remaining 1/3 was outstanding and unvested as of 12/31/2022. Assume the pension service cost for 2022 is \$100,000.

– Start with the “Total” reported for the PEO in the 2022 Summary Compensation Table: **\$2,200,000**

– Adjust For Equity Awards:

– Subtract the fair value of equity awards granted in 2022 that are reported in the 2022 Summary Compensation Table: **(\$900,000)**

– Add the fair value of equity awards granted in 2022 that remained outstanding and unvested as of 12/31/2022 (i.e., 2/3 of the \$900,000 of equity awards granted in 2022), based on the fair value of the awards as of such date (assume a 10% increase in fair value from grant date to 12/31/2022): **\$660,000**

– Add the *change* in fair value of the equity awards granted before 2022 that are outstanding and unvested as of 12/31/2022 (i.e., 1/3 of the \$600,000 in equity awards granted in 2021), based on the difference between the fair value of the awards as of such date compared to the fair value of such award as of 12/31/2021 (assume a 10% increase from 12/31/2021 to 12/31/2022): **\$20,000** (i.e., \$220,000 fair value as of 12/31/2022 less \$200,000 fair value as of 12/31/2021)

– Add the fair value of the awards that were granted and vested in 2022 (i.e., 1/3 of the \$900,000 in equity awards), based on the fair value of the awards as of the vesting date (assuming a 10% increase in fair value from grant date to the vesting date): **\$330,000**

– Add the *change* in fair value of all the equity awards granted before 2022 that vested in 2022 (i.e., 1/3 of the \$600,000 in equity awards granted in 2021), based on the difference between the fair value of the awards as of the vesting date

compared to the fair value of such award as of 12/31/2021 (assume a 25% increase from 12/31/2021 to the vesting date in 2022): **\$50,000** (i.e., \$250,000 fair value as of the vesting date in 2022 less \$200,000 fair value as of 12/31/2021).

– Adjust For Pension Benefits:

– Subtract the aggregate change in pension benefits reported in the 2022 Summary Compensation Table: **(\$200,000)**

– Add the pension “service cost” for 2022: **\$100,000**

The compensation “actually paid” to the PEO for 2022 is **\$2,260,000** (\$2,200,000 – \$900,000 + \$660,000 + \$20,000 + \$330,000 + \$50,000 - \$200,000 + \$100,000).

Q: What is the “Company-Selected Measure”?

A: The “Company-Selected Measure” must be a **financial** performance measure that is included in the Tabular List (as described below) that the company believes is the “most important” financial performance measure used by the company (that is not already included in the table) to align compensation “actually paid” to the NEOs with company performance.

A few key points to note regarding the “Company-Selected Measure”:

- The “Company-Selected Measure” must be picked from the Tabular List of the “most important” performance measures used by the company to link compensation to company performance. Although the Tabular List may include non-financial performance measures (as described below), the Company-Selected measure must be a **financial** performance measure.⁵
- The “most important” measure determination is made based on the most recently completed fiscal year. For example, if total revenue is a company’s “most important” measure for 2022 (and thus disclosed as the “Company-Selected Measure” in the 2023 proxy statement for 2022 and all prior covered years), but in 2023 the company’s “most important” measure is EBITDA (and thus disclosed as the Company-Selected Measure in the 2024 proxy statement for 2023), EBITDA would also apply for all prior covered years (including 2023) for purposes of “pay versus performance” disclosure in the 2024 proxy statement.
- If the company’s “most important” measure is already included in the tabular disclosure (TSR and net income), then the company is required to select its next-“most important” financial performance measure as the “Company-Selected Measure.”
- If the company does not use any financial performance measures to link compensation “actually paid” to company performance (or uses only measures already required to be disclosed in the table), then the company is not required to disclose a Company-Selected Measure, but must disclose this fact.
- If the Company-Selected Measure is a non-GAAP measure, the company must disclose how the number is calculated from the company’s audited financial statements (but is not otherwise required to comply with Regulation G relating to such Company-Selected Measure, similar to the requirement applicable to the disclosure of incentive compensation targets).

Q: How is the company’s peer group determined?

A: By using the same index or peers that the company uses either for purposes of the stock performance graph required under Item 201(e)(1)(ii) of Regulation S-K or in the CD&A for purposes of disclosing compensation benchmarking practices.

Item 201(e)(1)(ii) requires companies to provide a line graph comparing the yearly percentage change in their cumulative TSR with that of any of the following:

- A published industry or line-of-business index;
- Peer companies selected in good faith by the company; or

- Companies with similar market capitalizations (but only if the company does not use a published industry or line-of-business index and does not believe it can reasonably identify a peer group).

Alternatively, if the company uses a different peer group in the CD&A for purposes of describing compensation benchmarking practices, it may use that peer group for purposes of the final rule.

If the peer group is not a published industry or line-of-business index, the company must identify the companies comprising the group in a footnote. If the company disclosed the companies in its peer group in prior filings, it may incorporate those filings by reference.

If a company selects a different peer group from the peer group used by it for the immediately preceding fiscal year, the company must explain in a footnote the reason for the change and compare its TSR with that of both the new peer group and the peer group for the prior fiscal year. It is unclear from the final rule whether additional footnote disclosure will be required for minor changes in members of a company's peer group (i.e., the company changes one or two peer group companies, or one peer group company is acquired in a transaction or goes bankrupt and stops trading).

Companies should be mindful that, regardless of which peer group a company selects for purposes of the “pay versus performance” disclosure, proxy advisory firms may select different peer groups for purposes of their own analyses of the link between executive pay and the company's performance.

Q: How is cumulative TSR calculated?

A: In substantially the same manner as under Item 201(e), with the “measurement period” determined as described below.

For purposes of calculating the cumulative company TSR and cumulative peer group TSR, the term “measurement period” represents the period beginning at the “measurement point” established by the market close on the last trading day before the company's earliest covered fiscal year in the table, through and including the end of the covered fiscal year for which cumulative company TSR or cumulative peer group TSR is being calculated.

The closing price at the measurement point must be converted into a fixed investment of \$100 dollars, stated in dollars, in the company's shares or in the shares of the peer group companies. For each covered fiscal year, the amount included in the table must be the value of such fixed investment based on the cumulative TSR as of the end of that year. The same methodology must be used in calculating both the company's TSR and that of the peer group.

The final rule clarified that cumulative TSR is required to be disclosed for each covered year on a multi-year basis—i.e., the TSR for the first covered year in the table will represent the TSR over that first year, the TSR for the second year will represent the cumulative TSR over the first and second years, etc.

Example: In its 2023 annual proxy statement, a company that does not pay dividends is required to disclose its TSR for 2020 through 2022. At the market close on December 31 of 2019, 2020, 2021 and 2022, the company's share price is \$20, \$30, \$24 and \$27, respectively. The table below sets forth the company's cumulative TSR required to be reported in the pay versus performance table for each of 2020, 2021 and 2022, respectively, calculated based on an initial fixed investment of \$100, as required by the final rule.

Covered year	Measurement period and stock price at relevant measurement point	Cumulative TSR
2022	December 31, 2019 (\$20) to December 31, 2022 (\$27)	$(\$27 - \$20) / \$20 = 35\%$ $35\% * \$100 = \35
2021	December 31, 2019 (\$20) to December 31, 2021 (\$24)	$(\$24 - \$20) / \$20 = 20\%$ $20\% * \$100 = \20

2020	December 31, 2019 (\$20) to December 31, 2020 (\$30)	$(\$30 - \$20) / \$20 = 50\%$ $50\% * \$100 = \50
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When determining the cumulative TSR for peer companies, the company is required to disclose a weighted peer group TSR—i.e., weighted according to the respective peer companies' stock market capitalization at the beginning of each period for which a return is calculated.

Q: Do companies need to disclose how the “Company-Selected Measure” is calculated?

A: No. The final rule does not require companies to provide the methodology used to calculate the Company-Selected Measure.

However, the SEC stated that companies should consider if such disclosure would be helpful to investors to understand the Company-Selected Measure, or necessary to prevent the disclosure of the measure from being confusing or misleading. We expect the disclosure to be consistent with how the metric is disclosed in other SEC filings. As discussed above, if the Company-Selected Measure is a non-GAAP measure, the company must disclose how the number is calculated from the company's audited financial statements.

Disclosure of relationships between performance measures and compensation “actually paid”

Q: What relationships between performance measures and compensation “actually paid” are required to be disclosed?

A: Companies are required to use the information in the “pay versus performance” table to provide descriptions of the following relationships, in each case over the company's five most recently completed fiscal years (or shorter transitional period, if applicable):

- relationship between (i) compensation “actually paid” to the CEO and average compensation “actually paid” to the other NEOs and (ii) cumulative TSR of the company;
- relationship between (i) compensation “actually paid” to the CEO and average compensation “actually paid” to the other NEOs and (ii) net income of the company;
- relationship between (i) compensation “actually paid” to the CEO and average compensation “actually paid” to the other NEOs and (ii) the Company-Selected Measure; and
- relationship between (i) cumulative TSR of the company and (ii) cumulative TSR of the company's peer group.

In addition, if the company elects to provide any additional measure(s) in the table (as described below), each additional measure must also be accompanied by a description of the relationship between (i) the compensation “actually paid” to the CEO and average compensation “actually paid” to the other NEOs and (ii) such additional performance measure(s).

Q: How, and in what format, should companies describe these relationships?

A: Companies have flexibility on how to present the descriptions of these relationships.

Companies may describe the relationships either graphically or narratively, or using a combination of the two. Companies may also group any of these relationship disclosures together so long as any combined description of multiple relationships is “clear.”

Tabular list of “most important” performance measures

Q: What disclosure is required for the list of the “most important” performance measures used by the company?

A: A company is required to disclose a Tabular List of the three to seven “most important” financial performance measures used by the company to link compensation “actually paid” to the NEOs to company performance for the most recently completed fiscal year.

This list does **not** need to rank the performance measures, but, as noted above, the “Company-Selected Measure” must be selected from this list (i.e., as the “most important” financial performance measure for the last covered fiscal year).

This list may be presented in the form of:

- a single list covering all NEOs;
- two lists, with one covering the PEO and the other covering all of the non-PEO NEOs; or
- a separate list for the PEO and each non-PEO NEO.

If fewer than three financial performance measures were used by the company to link compensation “actually paid” to the company’s NEOs, for the most recently completed fiscal year, to company performance, the Tabular List must include all such measures that were used, if any.

Q: Can non-financial performance measures be disclosed as part of the Tabular List?

A: Yes. A company may include non-financial performance measures in the Tabular List if it determines that such measures are among its three to seven most important performance measures and it has disclosed its most important three (or fewer, if the company only uses fewer) financial performance measures.

However, the Tabular List may include up to a maximum of seven performance measures, regardless of whether the company elects to include non-financial performance measures in the Tabular List.

Other details

Q: May companies provide supplemental pay versus performance disclosure?

A: Yes.

A company may voluntarily provide supplemental measures of compensation or financial performance (in the table or in other disclosure), and other supplemental disclosure, if the company believes that the alternative measure provides useful information about the relationship between compensation and company performance, but only if any such measure or disclosure is clearly identified as supplemental, not misleading and not presented more prominently than the required disclosure.

Q: How does the final rule apply to SRCs?

A: As noted above, the final rule applies on a scaled-down basis to SRCs.

Specifically, the final rule exempts SRCs from the disclosure requirements, as follows:

- Only three years of pay versus performance disclosure are required (two years, for the first filing). Other companies are required to provide five years of disclosure (three years for the first filing, and four years for the second filing).
- No requirement to include the service cost under pension plans in calculating compensation “actually paid.”
- No requirement to disclose peer group TSR.
- No requirement to disclose a Company-Selected Measure.
- No requirement to describe any relationship involving peer group TSR or a Company-Selected Measure.
- No requirement to provide the unranked list of three to seven “most important” performance measures used by the company to link compensation “actually paid” to the NEOs to company performance.
- The requirement to present the disclosure in XBRL does not apply until the third filing.

Summary of the final rule and comparison to the proposed rule

The chart below summarizes the key differences between the disclosure requirements under the final rule and those initially proposed by the SEC in the 2015 proposed rule. The chart also summarizes which of the requirements under the final rule are applicable to SRCs and how the required disclosure should be presented in the proxy or information statement.

Category	Requirements under final rule	Comparison to the 2015 proposed rule	Applies to SRCs?	Format of disclosure
“Pay versus performance” table	Total PEO compensation reported in the Summary Compensation Table	Included in the proposed rule	Yes	Tabular disclosure, in accordance with the model table provided in the final rule (see Q&As below)
	Compensation “actually paid” to the PEO	Included in the proposed rule	Yes	
	Average total compensation for the non-PEO NEOs reported in the Summary Compensation Table	Included in the proposed rule	Yes	
	Average compensation “actually paid” to the non-PEO NEOs	Included in the proposed rule	Yes	
	Cumulative TSR of the company	Included in the proposed rule	Yes	
	Cumulative TSR of the company’s peer group	Included in the proposed rule	No	
	Net income of the company	<i>New requirement under the final rule</i>	Yes	
	Company-Selected Measure (which must be a financial performance measure)	<i>New requirement under the final rule</i>	No	
	Up to 5 years covered	Included in the proposed rule	Only up to 3 years covered	
Determining compensation “actually paid”	Equity awards valued using a “mark-to-market” approach (i.e., based on changes in fair value, determined as of the end of the covered year (or the vesting date, if vesting occurs during the covered year))	<i>New requirement under the final rule (under the proposed rule, equity awards were valued based on fair value on the vesting date only)</i>	Yes	Tabular (must include footnote disclosure of any valuation assumptions that materially differ from those disclosed at the time of grant)
	“Above-market” interest and preferential earnings on non-qualified deferred compensation is included	Included in the proposed rule	Yes	Tabular
	Add-backs for pension plan “service cost” and “prior service cost” (i.e., cost of benefits granted in a plan amendment (or initiation) relating to services rendered in prior periods)	<i>Add-back for “prior service cost” is a new requirement under the final rule</i>	No	Tabular

Disclosure of relationships	Between (i) (A) compensation “actually paid” to the PEO and (B) average compensation “actually paid” to the non-PEO NEOs and (ii) cumulative TSR of the company over all of the covered years	Included in the proposed rule	Yes	Graphically, narratively or a combination of the two
	Between (i) (A) compensation “actually paid” to the PEO and (B) average compensation “actually paid” to the non-PEO NEOs and (ii) net income of the company over all of the covered years	<i>New requirement under the final rule</i>	Yes	
	Between (i) (A) compensation “actually paid” to the PEO and (B) average compensation “actually paid” to the non-PEO NEOs and (ii) the Company-Selected Measure over all of the covered years	<i>New requirement under the final rule</i>	No	
	Between (i) cumulative TSR of the company and (ii) cumulative TSR of the company’s peer group over all of the covered years	Included in the proposed rule	No	
List of “most important ” performance measures	A list of 3 to 7 of the “most important” financial performance measures (with the ability to also include non-financial measures) used by the company to link compensation “actually paid” to the NEOs to company performance	<i>New requirement under the final rule</i>	No	Unranked Tabular List, which can be in the form of: one list covering all NEOs; two lists, with one covering the PEO and the other covering the non-PEO NEOs; or a separate list for the PEO and each non-PEO NEO

Next steps

Q: What should companies be doing now?

A: Companies, especially those who will be subject to the new requirements in the 2023 proxy season, should start to prepare now, including by taking the below actions.

Companies should consider taking the following actions now, as developing the new disclosure will require work:

- Start preparing the historical disclosure – companies can model how their cumulative TSR for the past two years (2021 and 2020) compares to the compensation “actually paid” to its CEO and other NEOs and to the cumulative TSR of its peers, as well as how such compensation “actually paid” compares to net income during such period;
- Determine what peer group to use and calculate their cumulative TSR;
- Start thinking about what performance measures (both financial and non-financial measures) the company considers to be most important with respect to linking NEO pay and company performance and preparing a list of those measures;
 - In considering this, companies should consider which financial measure is the “most important” to linking NEO pay to performance (if any) for 2022, and especially which measure will be the Company-Selected Measure for purposes of the tabular disclosure;
- Consider whether supplemental disclosure and/or alternative performance measures may be useful to address any perceived disconnect between pay and performance that might result from the mandated disclosure;
- Consider where the company will want to disclose the “pay versus performance” table and related narrative disclosure in the 2023 proxy statement, and start developing that disclosure in advance of the 2023 proxy season;
- Consider how the new pay versus performance disclosure may impact or interact with the other CD&A disclosure regarding performance measures, including ensuring that the chosen “most important” performance measures align with the company’s incentive plans; and
- Inform the company’s board of directors or the relevant committee(s) of the final rule and the story that it may tell regarding the relationship between NEO pay and company performance.

Appendix A

2. Amend § 229.402 by adding paragraph (v) to read as follows:

§ 229.402 (Item 402) Executive compensation.

* * * * *

(v) *Pay versus performance.* In connection with any proxy or information statement for which the rules of the Commission require executive compensation disclosure pursuant to this section (excluding any proxy or information statement of an “emerging growth company,” as defined in § 230.405 of this chapter or § 240.12b-2 of this chapter):

(1) Provide the information specified in paragraph (v)(2) of this section for each of the registrant’s last five completed fiscal years in the following tabular format:

Pay Versus Performance

Year (a)	Summary compensation table total for CEO (b)	Compensation actually paid to CEO (c)	Average summary compensation table total for non-CEO named executive officers (d)	Average compensation actually paid to non-CEO Named executive officers (e)	Value of initial fixed \$100 investment based on:		Net income (h)	[Company-selected measure] (i)
					Total shareholder return (f)	Peer group total shareholder return* (g)		

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(2) The table required by paragraph (v)(1) of this section must include:

(i) The fiscal year covered (column (a)).

(ii) The PEO's (as defined in paragraph (a)(3) of this section) total compensation for the covered fiscal year as reported in the Summary Compensation Table pursuant to paragraph (c)(2)(x) of this section, or paragraph (n)(2)(x) of this section for smaller reporting companies (column (b)), and the average total compensation reported for the remaining named executive officers collectively reported pursuant to such applicable paragraph (column (d)). If more than one person served as the registrant's PEO during the covered fiscal year, provide the total compensation, as reported in accordance with the immediately preceding sentence, for each person who served as the PEO during that period separately in an additional column (b) for each such person.

(iii) The executive compensation actually paid to the PEO (column (c)) and the average executive compensation actually paid to the remaining named executive officers collectively (column (e)). If more than one person served as the registrant's PEO during the covered fiscal year, provide the compensation actually paid to each person who served as PEO during that period separately in an additional column (c) for each such person. For purposes of columns (c) and (e) of the table required by paragraph (v)(1) of this section, executive compensation actually paid must be the total compensation for the covered fiscal year for each named executive officer as provided in paragraph (c)(2)(x) of this section, or paragraph (n)(2)(x) of this section for smaller reporting companies, adjusted to:

(A) Deduct the aggregate change in the actuarial present value of the named executive officer's accumulated benefit under all defined benefit and actuarial pension plans reported in the Summary Compensation Table in accordance with paragraph (c)(2)(viii)(A) of this section;

(B)(1) Add, for all defined benefit and actuarial pension plans reported in the Summary Compensation Table in accordance with paragraph (c)(2)(viii)(A) of this section, the aggregate of:

(i) service cost, calculated as the actuarial present value of each named executive officer's benefit under all such plans attributable to services rendered during the covered fiscal year; and

(ii) prior service cost, calculated as the entire cost of benefits granted (or credit for benefits reduced) in a plan amendment (or initiation) during the covered fiscal year that are attributed by the benefit formula to services rendered in periods prior to the amendment.

(2) "Service cost" and "prior service cost" must be calculated using the same methodology as used for the registrant's financial statements under generally accepted accounting principles.

(C)(1) Deduct the amounts reported in the Summary Compensation Table pursuant to paragraphs (c)(2)(v) and (c)(2)(vi) of this section and then include an amount calculated as follows for all stock awards, and all option awards, with or without tandem SARs (as defined in paragraph (a)(6)(i) of this section) (including awards that subsequently have been transferred):

(i) add the fair value as of the end of the covered fiscal year of all awards granted during the covered fiscal year that are outstanding and unvested as of the end of the covered fiscal year;

(ii) add the amount equal to the change as of the end of the covered fiscal year (from the end of the prior fiscal year) in fair value (whether positive or negative) of any awards granted in any prior fiscal year that are outstanding and unvested as of the end of the covered fiscal year;

(iii) add, for awards that are granted and vest in the same year, the fair value as of the vesting date;

(iv) add the amount equal to the change as of the vesting date (from the end of the prior fiscal year) in fair value (whether positive or negative) of any awards granted in any prior fiscal year for which all applicable vesting conditions were satisfied at the end of or during the covered fiscal year;

(v) subtract, for any awards granted in any prior fiscal year that fail to meet the applicable vesting conditions during the covered fiscal year, the amount equal to the fair value at the end of the prior fiscal year; and

(vi) add the dollar value of any dividends or other earnings paid on stock or option awards in the covered fiscal year prior to the vesting date that are not otherwise included in the total compensation for the covered fiscal year.

(2) If at any time during the last completed fiscal year, the registrant has adjusted or amended the exercise price of options or SARs held by a named executive officer, whether through amendment, cancellation or replacement grants, or any other means, or otherwise has materially modified such awards, the changes in fair value included pursuant to paragraph (v)(2)(iii)(C) of this section must take into account the excess fair value, if any, of any such modified award over the fair value of the original award as of the date of such modification.

(3) Fair value amounts must be computed in a manner consistent with the fair value methodology used to account for share-based payments in the registrant's financial statements under generally accepted accounting principles. For any awards that are subject to performance conditions, calculate the change in fair value as of the end of the covered fiscal year based upon the probable outcome of such conditions as of the last day of the fiscal year.

(iv) For purposes of columns (f) and (g) of the table required by paragraph (v)(1) of this section, for each fiscal year disclose the cumulative total shareholder return of the registrant (column (f)) and peer group cumulative total shareholder return (column (g)) calculated, except as set forth below, in the same manner as under § 229.201(e) of this chapter (Item 201(e) of Regulation S-K). For purposes of calculating the cumulative total shareholder return of the registrant and peer group cumulative total shareholder return, the term "measurement period" must be the period beginning at the "measurement point" established by the market close on the last trading day before the registrant's earliest fiscal year in the table, through and including the end of the fiscal year for which cumulative total shareholder return of the registrant or peer group cumulative total shareholder return is being calculated. The closing price at the measurement point must be converted into a fixed investment of one hundred dollars, stated in dollars, in the registrant's stock (or in the stocks represented by the peer group). For each fiscal year, the amount included in the table must be the value of such fixed investment based on the cumulative total shareholder return as of the end of that year. The same methodology must be used in calculating both the registrant's total shareholder return and that of the peer group. For purposes of determining the total shareholder return of the registrant's peer group, the registrant must use the same index or issuers used by it for purposes of § 229.201(e)(1)(ii) of this chapter or, if applicable, the companies it uses as a peer group for purposes of its disclosures under paragraph (b) of this section. If the peer group is not a published industry or line-of-business index, the identity of the issuers composing the group must be disclosed in a footnote. The returns of each component issuer of the group must be weighted according to the respective issuers' stock market capitalization at the beginning of each period for which a return is indicated. If the registrant selects or otherwise uses a different peer group from the peer group used by it for the immediately preceding fiscal year, explain, in a footnote, the reason(s) for this change and compare the registrant's cumulative total return with that of both the newly selected peer group and the peer group used in the immediately preceding fiscal year.

(v) The registrant's net income for each fiscal year (column (h)).

(vi) An amount for each fiscal year attributable to an additional financial performance measure included in the Tabular List provided pursuant to paragraph (v)(6) of this section, designated as the Company-Selected Measure, which in the registrant's assessment represents the most important financial performance measure (that is not otherwise required to be disclosed in the table) used by the registrant to link compensation actually paid to the registrant's named executive officers, for the most recently completed fiscal year, to company performance (column (i)).

For purposes of this paragraph (v) of this section, "financial performance measures" means measures that are determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements, any measures that are derived wholly or in part from such measures, and stock price and total shareholder return. A financial performance measure need not be presented within the registrant's financial statements or otherwise included in a filing with the Commission to be a Company-Selected Measure. Disclosure of any Company-Selected Measure, or any additional measure that the registrant elects to provide, that is not a financial measure under generally accepted accounting principles will not be subject to §§ 244.100 through 102 of this chapter (Regulation G) and § 229.10(e) of this chapter (Item 10(e)); however, disclosure must be provided as to how the number is calculated from the registrant's audited financial statements.

(3) For each amount disclosed in columns (c) and (e) of the table required by paragraph (v)(1) of this section, disclose in footnotes to the table each of the amounts deducted and added pursuant to paragraph (v)(2)(iii) of this section, the name of each named executive officer included as a PEO or in the calculation of the average remaining named executive officer compensation, and the fiscal years in which such persons are included. For disclosure of the executive compensation actually paid to named executive officers other than the PEO, provide the amounts required under this paragraph as averages.

(4) For the value of equity awards added pursuant to paragraph (v)(2)(iii)(C) of this section, disclose in a footnote to the table required by paragraph (v)(1) of this section any assumption made in the valuation that differs materially from those disclosed as of the grant date of such equity awards.

(5) In proxy or information statements in which disclosure is required pursuant to this Item, use the information provided in the table required by paragraph (v)(1) of this section to provide a clear description (graphically, narratively, or

a combination of the two) of the relationships:

(i) Between:

(A) The executive compensation actually paid by the registrant to the PEO (column (c)) and the average of the executive compensation actually paid to the named executive officers other than the PEO (column (e)) included in the Summary Compensation Table; and

(B) The cumulative total shareholder return of the registrant (column (f)), across the registrant's last five completed fiscal years;

(ii) Between:

(A) The executive compensation actually paid by the registrant to the PEO (column (c)) and the average of the executive compensation actually paid to the named executive officers other than the PEO (column (e)) included in the Summary Compensation Table; and

(B) Net income of the registrant (column (h)), across the registrant's last five completed fiscal years; and

(iii) Between:

(A) The executive compensation actually paid by the registrant to the PEO (column (c)) and the average of the executive compensation actually paid to the named executive officers other than the PEO (column (e)) included in the Summary Compensation Table; and

(B) The Company-Selected Measure (column (i)), across the registrant's last five completed fiscal years.

(iv) The description provided in response to paragraph (v)(5)(i) of this section must also include a comparison of the cumulative total shareholder return of the registrant (column (f)) and cumulative total shareholder return of the registrant's peer group (column (g)) over the same period. If a registrant elects to provide any additional measures in the table, each additional measure must be accompanied by a clear description of the relationship between:

(A) The executive compensation actually paid by the registrant to the PEO (column (c)) and the average of the executive compensation actually paid to the named executive officers other than the PEO (column (e)) included in the Summary Compensation Table; and

(B) That additional measure, across the registrant's last five completed fiscal years. (6) Subject to paragraph (v)(6)(iii) of this section, provide a tabular list of at least three, and up to seven, financial performance measures, which in the registrant's assessment represent the most important financial performance measures used by the registrant to link compensation actually paid to the registrant's named executive officers, for the most recently completed fiscal year, to company performance ("Tabular List").

(i) The registrant may provide the Tabular List disclosure either as one tabular list, as two separate tabular lists (one for the PEO, and one for all named executive officers other than the PEO), or as separate tabular lists for the PEO and each named executive officer other than the PEO. If the registrant elects to provide multiple tabular lists in accordance with the immediately preceding sentence, each tabular list must include at least three, and up to seven, financial performance measures, which in the registrant's assessment represent the most important financial performance measures used by the registrant to link compensation actually paid to that, or those, particular named executive officer, or officers, for the most recently completed fiscal year, to company performance.

(ii) If fewer than three financial performance measures were used by the registrant to link compensation actually paid to the registrant's named executive officers, for the most recently completed fiscal year, to company performance, the Tabular List must include all such measures that were used, if any.

(iii) A registrant may include non-financial performance measures (i.e., performance measures other than those that fall within the definition of financial performance measures) used by the registrant to link compensation actually paid to the registrant's named executive officers, for the most recently completed fiscal year, to company performance in the Tabular List, if it determines that such measures are among its three to seven most important performance measures, and it has disclosed its most important three (or fewer, if the registrant only uses fewer) financial performance measures, in accordance with this paragraph (v)(6).

(iv) The Tabular List may include a maximum of seven performance measures, regardless of whether the registrant elects to include non-financial performance measures in the Tabular List.

(7) The disclosure provided pursuant to this paragraph (v), including, but not limited to, any disclosure provided pursuant to paragraphs (v)(3) and (v)(6) of this section, must appear with, and in the same format as, the rest of the disclosure required to be provided pursuant to this section and, in addition, must be provided in an Interactive Data File in accordance with § 232.405 of this chapter and the EDGAR Filer Manual (referenced in § 232.301 of this chapter).

(8) A registrant that qualifies as a “smaller reporting company,” as defined by §229.10(f)(1) of this chapter, may provide the information required by this paragraph (v) for three years, instead of five years. A smaller reporting company may provide the disclosure required by this paragraph (v) for only two fiscal years in the first filing in which it provides this disclosure, and is not required to provide the disclosure required by paragraphs (v)(2)(iv) or (v)(5) of this section with respect to the total shareholder return of any peer group, or the Company-Selected Measure disclosure required by paragraph (v)(2)(vi) of this section, or the Tabular List provided pursuant to paragraph (v)(6) of this section. For purposes of paragraph (v)(2)(iii) of this section with respect to smaller reporting companies, executive compensation actually paid must be the total compensation for the covered fiscal year for each named executive officer as provided in paragraph (n)(2)(x) of this section, adjusted to deduct the amounts reported in the Summary Compensation Table pursuant to paragraphs (n)(2)(v) and (n)(2)(vi) of this section, and to add in their place the fair value of the amounts added in paragraph (v)(2)(iii)(C) of this section. Disclose in a footnote to the table required pursuant to paragraph (v)(1) of this section for the PEO and average remaining named executive officer compensation the amounts deducted from, and added to, the Summary Compensation Table pursuant to this instruction, the name of each named executive officer included as a PEO or in the calculation of the average remaining named executive officer compensation, and the fiscal years in which they are included. A smaller reporting company is required to comply with paragraph (v)(7) of this section in the third filing in which it provides the disclosure required by this paragraph (v).

Instructions to paragraph (v).

1. *Transitional relief.* A registrant may provide the disclosure required by this paragraph (v) for three years, instead of five years, in the first filing in which it provides this disclosure, and may provide disclosure for an additional year in each of the two subsequent annual filings in which this disclosure is required.
2. *New registrants.* Information for fiscal years prior to the last completed fiscal year will not be required if the registrant was not required to report pursuant to Section 13(a) or 15(d) of the Exchange Act (15 U.S.C. 78m(a) or 78o(d)) at any time during that year.
3. *Incorporation by reference.* The information required by paragraph (v) of this section will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

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.

Ning Chiu

+1 212 450 4908
ning.chiu@davispolk.com

Jennifer S. Conway

+1 212 450 3055
jennifer.conway@davispolk.com

Jeffrey P. Crandall

+1 212 450 4880
jeffrey.crandall@davispolk.com

Joseph A. Hall

+1 212 450 4565
joseph.hall@davispolk.com

Adam Kaminsky

+1 202 962 7180
adam.kaminsky@davispolk.com

Kyoko Takahashi Lin

+1 212 450 4706
kyoko.lin@davispolk.com

Emily Roberts

+1 650 752 2085
emily.roberts@davispolk.com

Travis Triano

+1 212 450 3096
travis.triano@davispolk.com

Veronica M. Wissel

+1 212 450 4794
veronica.wissel@davispolk.com

Chaoyuan (Charles) Shi

+1 212 450 3346
charles.shi@davispolk.com

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- ¹ For additional information, see our [2015 client update](#) on the proposed rule, [our 2015 comment letter](#) submitted to the SEC and our [2022 client update](#) on the reopening of the comment period.
- ² EGCs include issuers that completed their IPOs after December 8, 2011, and that have less than \$1.07 billion in total annual gross revenues during their most recently completed fiscal year. An issuer remains an emerging growth company until the earliest of (i) the last day of the fiscal year in which it has total annual gross revenues in excess of \$1.07 billion, (ii) the last day of the fiscal year following the fifth anniversary of its IPO, (iii) the date on which it has issued more than \$1 billion in non-convertible debt in the last three-year period and (iv) the date on which it becomes a "large accelerated filer."
- ³ Business development companies (BDCs) (which are a type of closed-end investment company that is not registered under the Investment Company Act) will be subject to the final rule and will be treated like other non-SRC companies (i.e., BDCs do not fall within the definition of an SRC and so are not eligible for the scaled disclosure applicable to SRCs).
- ⁴ The SEC clarifies in its release that this should only include the dollar value of any dividends or other earnings paid on equity awards that are not otherwise reflected in the fair value of such awards.
- ⁵ "Financial performance measures" means measures that are determined and presented in accordance with the accounting principles used in preparing the company's financial statements, any measures that are derived wholly or in part from such measures, and stock price and TSR.