

SEC Staff issues interpretations regarding the “pay versus performance” disclosure rule

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On February 10, 2023, the SEC Staff issued a set of Compliance & Disclosure Interpretations (C&DIs) regarding the “pay versus performance” (PvP) disclosure rule, which covers a variety of topics, including the calculation and disclosure of compensation “actually paid” to named executive officers (NEOs), use of peer groups and a company’s selection of its “company-selected measure” (CSM). Many calendar-year companies will need to immediately review these C&DIs and digest their implications.

Executive summary

On February 10, 2023, the SEC Staff issued fifteen [Compliance & Disclosure Interpretations](#) regarding its PvP disclosure rule. These C&DIs, which comprise the Division of Corporation Finance’s interpretations of Item 402(v) of Regulation S-K, answer a number of questions, in a generally reasonable manner, although some questions remain unanswered. The text of these C&DIs can be found at [Appendix A](#).

Review of the final rule

The [SEC’s PvP rule](#),¹ which was finalized on August 25, 2022, added new Item 402(v) to Regulation S-K, which 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 PvP table, covering up to five years (with fewer years during a transition period before full compliance is required) 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 PvP 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” final performance measures used by the company to link compensation “actually paid” to the NEOs to company performance.²

Topics covered

The C&DIs are the first set of guidance from the SEC Staff on the PvP rule since its adoption in August 2022 and cover a broad range of topics, as described below.

General

Q: Is PvP disclosure required in a Form 10-K?

A: No.

C&DI 128D.01 clarifies that PvP disclosure is only required in a proxy or information statement for which the SEC's rules require inclusion of executive compensation disclosure pursuant to Item 402. Thus, the disclosure is not required in a Form 10-K. Further, Instruction 3 to Item 402(v) specifies that the information provided under Item 402(v) will not be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act 1934, except to the extent that the company specifically incorporates it by reference.

Compensation “actually paid”

Q: For a first-time NEO, are equity awards granted in a year prior to his or her appointment as an executive officer required to be included?

A: Yes.

C&DI 128D.02 clarifies that, if a non-NEO employee is granted an equity award in Year 1 and is subsequently appointed as an executive officer in Year 2 (for example, as a result of a promotion), that NEO's compensation “actually paid” in Year 2 must reflect the change in the fair value of that Year 1 equity award in the equity adjustments required by subparagraphs (ii), (iv) or (v) (relating to prior-year fiscal year awards) of Item 402(v)(2)(iii)(C)(1). This is the case, even though the Year 1 equity award will never be reported in a Summary Compensation Table for that NEO.

Q: Regarding the equity adjustments required by Item 402(v)(2)(iii), is footnote disclosure required for each of the fiscal years presented in the PvP table?

A: Generally no; however, in the first year, companies should provide footnote disclosure for each of the periods presented in the PvP table.

C&DI 128D.03 notes that Item 402(v)(3) requires, for each amount disclosed in the compensation “actually paid” columns (i.e., columns (c) and (e)) of the PvP table, footnote disclosure for each of the amounts deducted and added pursuant to Item 402(v)(2)(iii). For years other than the most recent fiscal year included in the table, this footnote disclosure is required only if it is material to an investor's understanding of the information reported in the table for the most recent fiscal year, or the relationship disclosure provided under Item 402(v)(5). However, in the company's first PvP table, companies should provide footnote disclosure for each of the periods presented in the table.

Q: Regarding the pension and equity adjustments required by Item 402(v)(2)(iii), can the footnote disclosure aggregate all pension adjustments and all equity adjustments?

A: No.

C&DI 128D.04 clarifies that companies should provide footnote disclosure for each of the amounts deducted and added pursuant to Items 402(v)(2)(iii)(B)(1)(i) – (ii) and Items 402(v)(2)(iii)(C)(i) – (vi).

Example: We have received a number of questions from companies about how to present the disaggregated footnote disclosure. While it can take various forms, here is just one example of how those adjustments could be presented:

Year	Reported summary compensation table total for PEO (\$)	Reported value of equity awards (\$) (a)	Equity award adjustments (\$) (b)	Reported change in the actuarial present value of pension benefits (\$) (c)	Pension benefit adjustments (\$) (d)	Compensation actually paid to PEO (\$)
2022	[.]	[.]	[.]	[.]	[.]	[.]
2021	[.]	[.]	[.]	[.]	[.]	[.]
2020	[.]	[.]	[.]	[.]	[.]	[.]

(a) The reported value of equity awards represents the grant date fair value of equity awards as reported in the “Stock Awards” column of the Summary Compensation Table for each applicable year.

(b) The equity award adjustments for each applicable year include the addition (or subtraction, as applicable) of the following:

(i) the year-end fair value of any equity awards granted in the applicable year that are outstanding and unvested as of the end of the year;

(ii) the amount of change in fair value as of the end of the applicable year (from the end of the prior fiscal year) of any awards granted in prior years that are outstanding and unvested as of the end of the applicable year;

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

(iv) for awards granted in prior years that vest in the applicable year, the amount equal to the change in fair value as of the vesting date (from the end of the prior fiscal year);

(v) for awards granted in prior years that are determined to fail to meet the applicable vesting conditions during the applicable year, a deduction for the amount equal to the fair value at the end of the prior fiscal year; and

(vi) the dollar value of any dividends or other earnings paid on equity awards in the applicable year prior to the vesting date that are not otherwise reflected in the fair value of such award or included in any other component of total compensation for the applicable year.

The amounts deducted or added in calculating the equity award adjustments are as follows:

Year	Year end fair value of equity awards granted during the year (\$)	Year over year change in fair value of outstanding and unvested equity awards (\$)	Fair value as of vesting date of equity awards granted and vested in the year (\$)	Year over year change in fair value of equity awards granted in prior years that vested in the year (\$)	Fair value at the end of the prior year of equity awards that failed to meet vesting conditions in the year (\$)	Value of dividends or other earnings paid on stock or option awards not otherwise reflected in fair value or total compensation (\$)	Total equity award adjustments (\$)
2022	[.]	[.]	[.]	[.]	[.]	[.]	[.]
2021	[.]	[.]	[.]	[.]	[.]	[.]	[.]
2020	[.]	[.]	[.]	[.]	[.]	[.]	[.]

(c) The amounts in this column represent the amounts reported in “Change in Pension and Nonqualified Deferred Compensation” column of the Summary Compensation Table for each applicable year.

(d) The total pension benefit adjustments for each applicable year include the aggregate of two components: (i) the actuarially determined service cost for services rendered by the PEO during the applicable year (the “service cost”); and (ii) the entire cost of benefits granted in a plan amendment (or initiation) during the applicable year that are attributed by the benefit formula to services rendered in periods prior to the plan amendment or initiation (the “prior service cost”), in each case, calculated in accordance with U.S. GAAP. The amounts deducted or added in calculating the pension benefit adjustments are as follows:

Year	Service cost (\$)	Prior service cost (\$)	Total pension benefit adjustments (\$)
2022	[.]	[.]	[.]
2021	[.]	[.]	[.]
2020	[.]	[.]	[.]

An alternative to the foregoing tabular approach is one where the adjustments are noted in the text of a footnote.

Peer groups and TSR

Q: May companies use a peer group that is disclosed in their Compensation Disclosure & Analysis (CD&A), even if it is not used for compensation benchmarking purposes?

A: Yes.

C&DI 128D.05 clarifies that companies may use any peer group that is disclosed in the CD&A as a peer group actually used by the company to help determine executive pay, even if the peer group is not used specifically for “benchmarking” purposes under Item 402(b)(2)(xiv).

This C&DI may surprise some, as it had previously been rumored that the SEC would only permit a peer group that was used for compensation benchmarking purposes. As a result and also because of the convenience of using the alternative that is acceptable to the SEC, namely the ready-made peer group required under Item 201(e)(1)(ii) for purposes of its performance graph, many companies have decided to use the performance graph peer group, but they may wish to revisit this. In no event, however, may a company use the Standard & Poor’s 500 Stock Index as its PvP peer group, unless it is disclosed in the CD&A as a peer group that is used to determine executive pay.

Q: What time period is a company required to present for its cumulative TSR and peer group TSR if the company went public during the earliest year included in the PvP table?

A: *The measurement period of calculating TSR and peer group TSR should begin on the company’s registration date.*

C&DI 128D.06 clarifies this point for newly public companies, noting that this methodology is consistent with the calculation for TSR under Item 201(e) of Regulation S-K.

Q: If a company changes its peer group during the years covered by the PvP table, may it present the peer group TSR for each of the years using the most recent peer group?

A: No.

C&DI 128D.07 provides an example – for each of 2020 and 2021, a company uses a CD&A peer group that contains the same list of companies; however, the composition of the peer group changes for 2022. In this case, the company cannot present the peer group TSR for each of the three years of 2020, 2021 and 2022 by using the 2022 peer group. It must

present the peer group TSR for each year using the peer group disclosed in its CD&A for such year.

As a practical matter, changes to the peer group will result in additional disclosure. This is another reason why companies may prefer to use their performance graph peer group, rather than a different peer group that is disclosed in the CD&A.

Performance measures, including the company-selected measure (CSM)

Q: For purposes of the required “net income” measure in the PvP table (i.e., Item 402(v)(2)(v)), may a company use a non-GAAP net income measure?

A: No.

C&DI 128D.08 clarifies that companies must use its net income or loss as required by Regulation S-X to be disclosed in its audited GAAP financial statements. Companies may not use other net income amounts, such as net income attributable to a controlling interest or the company, or net income from continuing operations, even if such amounts are also presented in the audited financial statements.

Q: May a company use a CSM that is derived from, a component of, or similar to net income or cumulative TSR?

A: Yes.

C&DI 128D.09 clarifies that the CSM may 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, a component of, or similar to those required measures, such as earnings per share, gross profit, income or loss from continuing operations or relative TSR. Any such measures can also be included as financial performance measures in the Tabular List required by Item 402(v)(6).

This flexibility should prove helpful to companies. For example, this means companies may use one of the measures noted above, as well as operating income and TSR that is calculated differently from the way that the SEC calculates cumulative TSR.

Q: May a company use stock price as its CSM?

A: No, not unless the company uses stock price as a performance measure in its compensation program, even if stock price has a significant impact on the amounts reported in the PvP table.

C&DI 128D.10 clarifies that, if the only impact of stock price on a NEO's compensation is through changes in the value of share-based awards, then the company cannot use stock price as its CSM. In other words, stock price can be used only when it is specifically used as a performance measure in an incentive plan or linked to an award, but not when it is just considered by the company's compensation committee.

However, if the company's stock price is a market condition applicable to an equity award, or is used to determine the size of a bonus pool, it may be included as its CSM. One implication of this is that, if a company has granted equity awards that vest or become exercisable on the basis of stock price hurdles, which is the case for a number of multi-year grants made in the last few years, it could use stock price as a CSM.

The C&DI is focused on stock price as a potential CSM; however, given the language of the C&DI, we query whether stock price can be included in the Tabular List of three to seven of the “most important” final performance measures for companies that do not use stock price as an actual performance measure in their incentive or equity plan.

Q: May the CSM be measured over a multi-year period that includes the applicable fiscal year as the final year, similar to the use of multi-year measurement periods for calculating TSR under Item 402(v)(2)(iv)?

A: No.

C&DI 128D.11 clarifies that, under Item 402(v)(2)(vi), the CSM is the measure that, in the company's assessment, represents the most important financial performance measure (that is not otherwise required to be disclosed in the PvP table) used by the company to link compensation "actually paid" to the NEOs for the most recently completed fiscal year to company performance.

This may seem restrictive for companies, especially for those that were considering using a performance measure that is used in their long-term incentive plan, which typically covers a multi-year period, as their CSM. For these companies, a one-year measurement period may not align with how they think about their most important financial performance measure.

Q: If a company uses a "pool plan" to determine its annual bonus plans, where the bonus pool is available for payout only upon achievement of a financial performance measure or the size of the pool is determined based upon the extent such measure is achieved, and actual bonuses are allocated on a discretionary basis, may it omit the CSM required under Item 402(v)(2)(vi), the Tabular List required under Item 402(v)(6) and the relationship disclosure required under Item 402(v)(5)(iii), if it does not use any other financial performance measure?

A: No.

C&DI 128D.12 clarifies that, because the size of the bonus pool is determined based on the satisfaction of a financial performance measure, the company is using the measure to link compensation "actually paid" to company performance, so it must disclose it.

Other

Q: If a company has multiple PEOs in a fiscal year, may the company aggregate such compensation of such PEOs in a given year for purposes of the relationship disclosure required under Item 402(v)(5)?

A: Generally, yes.

C&DI 128D.13 clarifies that, as long as the presentation will not be misleading to investors, a company may aggregate multiple PEOs' compensation for purposes of the narrative, graphical or combined comparison between compensation "actually paid" and TSR, net income and the CSM. Note that the company cannot use this aggregated approach in the PvP table itself – in the table, it must provide separate columns for each PEO.

Q: If a company changes its fiscal year during the time period covered by the PvP table, what should it do?

A: The company should provide the disclosure for the "stub period" and should not annualize or restate compensation.

C&DI 228D.01 provides an example – if, in late 2022, a company that is not a smaller reporting company changes its fiscal year end from June 30 to December 31, in the company's PvP table, it should provide disclosure for each of the following four periods: July 1, 2022 to December 31, 2022, July 1, 2021 to June 30, 2022, July 1, 2020 to June 30, 2021 and July 1, 2019 to June 30, 2020. The company should continue to provide such disclosure, including the stub period, until there is disclosure for five full fiscal years after the stub period. The C&DI notes that this approach is consistent with the approach applicable to the Summary Compensation Table.

Q: If a company emerges from bankruptcy, and a new class of stock is issued under the bankruptcy plan, how should it present the PvP table?

A: The company may present cumulative TSR and peer group cumulative TSR using a measurement period that starts with when its stock starts trading.

C&DI 228D.02 provides an example – a company emerges from bankruptcy and its common stock starts trading in September 2020. For the company's first PvP disclosure to be included in the 2023 proxy statement, it may provide cumulative TSR and peer group cumulative TSR using a measurement period from September 2020 through December

2022, similar to what they may do with its performance graph under Item 201(e). Companies should provide footnote disclosure explaining this approach and its effect on the table itself.

Further considerations

Q: What questions do the C&DIs not address?

A: Several frequently asked questions are not answered, such as the circumstances under which it would not be necessary to add the dollar value of any dividends or other earnings paid on equity awards in the applicable year prior to the vesting date, whether to treat equity awards that are subject to retirement eligibility provisions as vested at grant, or questions regarding the use of the performance graph under Item 201(e).

Q: Will the SEC issue additional C&DIs?

A: Given the timing of these C&DIs relative to when companies will need to provide this disclosure in their proxy or information statement, it is unlikely that the SEC Staff will release additional C&DIs during this proxy season, at least for calendar year companies. We have not heard one way or another, but the Staff may issue additional C&DIs to the extent that companies continue to have questions.

Q: What should companies do now?

A: As we write this, many calendar year companies are actively preparing their PvP disclosure. They will need to immediately review the SEC's C&DIs and digest their implications.

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

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

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¹ Our client update on the final pay versus performance rule can be found [here](#).

² Smaller reporting companies are subject to the final rule, but with more scaled-down disclosure requirements that are phased in over time.