

Technical Line

How to apply the SEC's new pay versus performance disclosure requirements

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What you need to know

- ▶ Registrants will need to make new calculations and have processes and controls in place to comply with SEC rules that require disclosure in proxy and information statements of the relationship between executive compensation and financial performance (i.e., total shareholder return, net income and a company-selected measure) for the five most recently completed fiscal years.
- ▶ To determine actual executive compensation paid, registrants are required to make certain adjustments to the total executive compensation they report in the summary compensation table.
- ▶ The rules apply to all registrants except emerging growth companies, foreign private issuers and registered investment companies other than business development companies. Smaller reporting companies may provide scaled disclosures.
- ▶ Calendar-year registrants must begin providing the disclosures in proxy and information statements in early 2023.
- ▶ This publication was updated to reflect the SEC staff's recently published compliance and disclosure interpretations on the rules.

Overview

The **final amendments** to Regulation S-K that the Securities and Exchange Commission (SEC) recently adopted require registrants to provide a table, in their proxy and information statements, that discloses the relationship between their executive compensation and their

financial performance for their five most recently completed fiscal years. The amendments also require registrants to describe the relationship between the executive compensation they actually paid and their financial performance and provide a list of three to seven of the most important financial measures they use to link the executive compensation they paid to their performance for the most recent fiscal year.

The SEC said the amendments are intended to provide investors with more transparent and comparable disclosures of registrants' executive compensation in the context of their financial performance. "I think that this rule will help investors receive the consistent, comparable, and decision-useful information they need to evaluate executive compensation policies," said SEC Chair Gary Gensler. The disclosures were mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act and originally proposed by the SEC in 2015.

New Item 402(v) of Regulation S-K requires registrants to include pay versus performance (PvP) disclosures in proxy statements for annual or special shareholder meetings (i.e., Schedule 14A) or information statements (i.e., Schedule 14C) in which executive compensation disclosures are required under Item 402. Registrants are not required to provide the disclosures in annual reports or registration statements filed under the Securities Act of 1933.¹

The rules apply to all reporting companies except emerging growth companies (EGCs), foreign private issuers and registered investment companies other than business development companies. Smaller reporting companies (SRCs) are permitted to provide scaled disclosures.

The new pay versus performance disclosures are only required in proxy and information statements.

Pay versus performance table

A registrant is required to provide a table that includes the following information for up to five years (three years for SRCs):

- ▶ The total executive compensation reported in the summary compensation table for the principal executive officer (PEO) and the average (i.e., mean) total compensation for the other named executive officers (NEOs)
- ▶ The "actual" compensation paid to the PEO and the other NEOs
- ▶ The total shareholder return (TSR) for both the registrant and its peer group, calculated as the value of an initial \$100 investment
- ▶ Net income presented in its audited GAAP financial statements (other subtotals, such as net income attributable to the registrant and net income attributable to continuing operations, are not permitted as a substitute for the required net income disclosure on the PvP table)
- ▶ A company-selected financial measure

Smaller reporting companies aren't required to make some of these disclosures, as discussed in the *Smaller reporting companies* section below.

This publication describes how to calculate the amounts in each column of the new table, which will look like this:

Pay versus performance table									
(a)	(b)	(c)	(d)	(e)	(f)		(g)	(h)	(i)
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:		Peer group total shareholder return	Net income	Company-selected measure
					Total shareholder return				

Summary compensation table total for PEO and NEOs

The rules require registrants to disclose information pertaining to both PEOs and other NEOs, including separate disclosure of the PEO's total compensation and other NEOs' average total compensation calculated in accordance with Item 402(c)(2)(x) of Regulation S-K or Item 402(n)(2)(x) of Regulation S-K for SRCs (i.e., amounts disclosed in the summary compensation table under other SEC executive compensation disclosure requirements).

For a year in which a registrant had more than one PEO, the registrant is required to provide separate columns for information about each PEO. That is, the registrant would provide summary compensation table totals for each PEO and compensation actually paid for each PEO. The table below shows the required disclosure for a year in which a registrant had two PEOs in "Year 2."

Pay versus performance table											
(a)	(b)	(b)	(c)	(c)	(d)	(e)	(f)		(g)	(h)	(i)
Year	Summary compensation table total for first PEO	Summary compensation table total for second PEO	Compensation actually paid to first PEO	Compensation actually paid to second 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:		Peer group total shareholder return	Net income	Company-selected measure
							Total shareholder return	Peer group total shareholder return			
Y1	N/A	\$	N/A	\$	\$	\$	\$	\$	\$	\$	\$
Y2	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Y3	\$	N/A	\$	N/A	\$	\$	\$	\$	\$	\$	\$
Y4	\$	N/A	\$	N/A	\$	\$	\$	\$	\$	\$	\$
Y5	\$	N/A	\$	N/A	\$	\$	\$	\$	\$	\$	\$

Registrants are required to report one total for average compensation for other NEOs and one total for compensation actually paid to this group for each year, even if there is a change in the individuals included in the group during the year. For example, if an NEO leaves the company, the registrant would need to include that individual's total compensation and the successor NEO's total compensation through the end of the year. Registrants are also required to disclose in a footnote to the table the names of NEOs whose compensation amounts are included in the average for each year to help investors understand whether changes in the NEOs' compensation were due to changes in the composition of the group.

A registrant that changes its fiscal year during the time period covered by the PvP table should provide the PvP disclosures for the "stub period" and should not annualize or restate compensation. This is consistent with the approach applicable to the Summary Compensation Table for changes in fiscal year end.

Determining executive compensation actually paid

To determine the executive compensation that is "actually paid" for the PEO and NEOs in a given fiscal year, registrants are required to make certain adjustments to the total executive compensation reported in the summary compensation table for pension and equity awards that are calculated in accordance with US GAAP.

Registrants must provide footnote disclosure to describe the adjustments they make to calculate "executive compensation actually paid" for their most recent fiscal year, and for other years if it is material to an investor's understanding of the information reported in the most recent fiscal year, or to the relationship between compensation and performance. Registrants must describe the adjustments for all periods presented the first time they provide the table. The SEC staff said that registrants must describe each adjustment in this footnote disclosure and may not describe the adjustments in the aggregate (e.g., describe all pension adjustments as one adjustment).

Consistent with the requirements for the summary compensation table, registrants are required to include signing bonuses, severance bonuses and other one-time payments in the amount of compensation actually paid.

Pension benefits

To compute actual compensation paid, registrants are required to make the following adjustments to the total executive compensation reported in the summary compensation table:

- ▶ Deduct the aggregate change in the actuarial present value of the accumulated benefit of all defined benefit and actuarial pension plans reported in the summary compensation table
- ▶ Add back the following:
 - ▶ The actuarially determined service cost for services rendered by the executive during the covered fiscal year (i.e., the service cost)
 - ▶ The entire cost of benefits granted 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 plan amendment or initiation (i.e., the prior service cost)

The service cost and the prior service cost should be calculated using the principles in Accounting Standards Codification (ASC) 715, *Compensation – Retirement Benefits*. See our Financial reporting developments publication, ***Postretirement benefits***, for additional information about how to calculate service cost and prior service cost under US GAAP.

Registrants are only required to deduct a positive change in actuarial present value and not a negative change, because any negative change would not be included in the summary compensation table and would only be disclosed in a note.

Deducting the aggregate change in the actuarial present value of the accumulated benefit of all pension benefits and only adding the service cost and the prior service cost also avoids potential volatility that could occur if previously accumulated benefits were revalued to reflect changes in actuarial inputs and assumptions, such as changes in interest rates.

How we see it

Executive compensation actually paid would include the entire prior service cost related to plan amendments for each covered fiscal year. That would differ from how registrants recognize the amounts in their financial statements.

That's because, under ASC 715, entities are required to defer prior service cost or credit in accumulated other comprehensive income and amortize that cost or credit to net periodic benefit cost over the expected service period. As a result, registrants recognize only the amortized amount in their financial statements each year.

Equity awards

Registrants are also required to make the following adjustments to the total executive compensation reported in the summary compensation table related to equity compensation:

- ▶ Deduct the grant date fair value of equity award amounts reported in the summary compensation table and add back (or subtract, as applicable) the following in the covered fiscal year:
 - ▶ The year-end fair value of any equity awards granted during the covered fiscal year that are outstanding and unvested as of the end of the fiscal year

- ▶ The change in fair value of any awards granted in prior years that are outstanding and unvested as of the end of the fiscal year
- ▶ For awards that are granted and vest in the same year, the fair value as of the vesting date
- ▶ For awards granted in prior years that vest in the fiscal year, the change in the fair value from the end of the prior fiscal year to the vesting date
- ▶ For awards granted in prior years that are determined to fail to meet the applicable vesting conditions (i.e., are forfeited), deduct the amount equal to the fair value at the end of the prior fiscal year
- ▶ The amount of any dividends or other earnings paid on equity awards in the fiscal year prior to the vesting date that is not otherwise reflected in the fair value of such award or included in total compensation for the covered fiscal year

Registrants are required to measure the year-end fair value of their outstanding and unvested equity awards to their executives using the same methodology as required under US GAAP.

The amendments require registrants to disclose the fair value of equity awards in the year they are granted and then report changes in the fair value of awards until they vest. To do so, registrants are required to measure the year-end fair value of their outstanding and unvested equity awards to their CEO and other NEOs using the same methodology as required under US GAAP.

When calculating executive “compensation actually paid” in the first year an employee becomes a NEO, a registrant must include the change in fair value of all equity awards issued to the employee, including those granted before the employee became a NEO.

The SEC staff said that when valuing equity awards for the PVP disclosures, registrants generally should follow the measurement principles for valuing equity awards under US GAAP.

The staff expects registrants to measure the year-end fair value of their outstanding and unvested option equity awards using the same methodology and assumptions required under US GAAP. For example, a registrant cannot rely on a method to determine the expected term assumption that is not acceptable under US GAAP, including simply subtracting the elapsed actual life from the grant date expected term assumption without considering any of the other factors for determining the expected term under US GAAP. The expected term for options referred to as “plain vanilla” in Staff Accounting Bulletin (SAB) 14.D.2 should not be determined using the “simplified” method described in that SAB if those options do not meet the “plain vanilla” criteria at the remeasurement date, such as when the option is out of the money at the remeasurement date.

When dividends are reflected in the fair value of equity awards, registrants should not include dividend amounts in executive compensation actually paid.

The SEC staff will not object if registrants use a different valuation technique than the one they used to determine the grant date fair value of share-based payments in their US GAAP financial statements, if the other technique provides a better estimate of fair value after the grant date (i.e., at the remeasurement date for the PVP disclosures) and is permitted under US GAAP. The SEC staff also clarified that a registrant that uses a different valuation technique than the one it used to determine the grant date fair value of share-based payments should disclose the change if the technique differs materially. The SEC staff expects a registrant to disclose both the change and the reason for the change.

In addition, registrants are required to disclose any valuation assumptions that materially differ from those disclosed at grant date. Although the final rules are not prescriptive on the assumption disclosure, the staff believes a registrant could provide the disclosures about valuation assumptions as required under ASC 718 (e.g., including a range of assumptions when a range of assumptions is used).

If disclosing valuation assumptions would involve disclosing confidential trade secrets or confidential commercial or financial information (e.g., performance-related targets), the registrant may omit such information to the extent it would be subject to the confidentiality protections of Instruction 4 to Item 402(b) of Regulation S-K. However, the registrant must provide as much information responsive to the disclosure requirement as possible without disclosing the confidential information, such as a range of outcomes or a discussion of how a performance condition impacted the fair value. The registrant should also discuss how a material difference in the assumption affects the likelihood that the performance target will be achieved.

How we see it

Registrants should establish a process and controls to calculate executive compensation actually paid, even though some of the data used in the calculation is derived from the GAAP financial statements or is consistent with measurements used in preparing the financial statements.

Registrants should also establish a process and controls for remeasuring and tracking changes in the fair value of the PEO's and NEOs' equity awards annually until they vest since remeasurement isn't always required to prepare the financial statements. For example, a registrant may need to engage a third-party specialist to perform an annual valuation of certain types of equity awards (e.g., those with market conditions).

Awards with performance and market conditions

For an equity award with a performance condition, a registrant should determine the probability of the condition occurring as of the last day of the fiscal year and take that into account in its year-end measurement of fair value. This probability assessment is already performed at each reporting period because under ASC 718, *Compensation – Stock Compensation*, compensation cost is recognized if it is probable that the performance condition will be satisfied. However, if it is not probable that a performance condition will be met, no compensation cost is recognized.

A performance-based vesting condition is considered satisfied when it is achieved. However, certain performance-based awards may require the compensation committee to certify the level of performance attained. A registrant should analyze such requirement to determine whether it creates an additional substantive vesting condition (e.g., an employee does not vest in the award unless and until the employee remains employed through the date such certification occurs). If certification is deemed to be an additional substantive vesting condition, the award would not vest until such condition is met.

Illustration 1 – Determining compensation actually paid for an equity award with a performance condition

A calendar-year registrant grants 100 stock options to its PEO on 1 January 2022. The award will vest and become exercisable if the company's sales target increases by at least 10% by 31 December 2024 and if the executive stays for three years. The registrant estimates at the grant date that its sales target will grow at least 10% over the three-year performance period. It also determines that the total compensation cost to be recognized if the performance condition is satisfied would be \$1,000. The grant date fair value of the award is included in the summary compensation table for the year ended 31 December 2022, the year in which the award was granted.

Year 1 – 31 December 2022

On 31 December 2022, the registrant remeasures the fair value of the unvested options as \$1,100, using the same valuation methodology, and considers the probability of the performance condition occurring as of the last day of the fiscal year. As of 31 December 2022, it is still probable that the performance condition will be met. To calculate the actual compensation paid to the PEO for the year ended 31 December 2022, the registrant deducts the \$1,000 grant date fair value reflected in the summary compensation table for the award and adds \$1,100, which represents the fair value of the outstanding and unvested award as of 31 December 2022.

Year 2 – 31 December 2023

On 31 December 2023, the registrant remeasures the fair value of the unvested options as \$1,400, using the same valuation methodology, and considers the probability of the performance condition occurring as of the last day of the fiscal year. As of 31 December 2023, it is still probable that the performance condition will be met. To calculate the actual compensation paid to the PEO for the year ended 31 December 2023, the registrant adds \$300, which represents the increase in the fair value of the outstanding and unvested award as of 31 December 2023.

Year 3 – 31 December 2024

During 2024, sales decline, and on 31 December 2024, the registrant determines that the performance condition has not been met and the award will not vest. To calculate the actual compensation paid to the PEO for the year ended 31 December 2024, the registrant deducts \$1,400, which represents the reversal of the cumulative reported value of the award since it didn't vest on 31 December 2024.

Although a market condition is not considered a vesting condition under ASC 718, the SEC staff clarified that market conditions should be considered in determining whether the vesting conditions of awards have been met (i.e., registrants must include in executive compensation actually paid any change in fair value of awards subject to market conditions until the market conditions are satisfied). Similarly, registrants must deduct the fair value of awards with market conditions at the end of the prior fiscal year when those awards fail to meet the market condition during the covered fiscal year and are forfeited.

Illustration 2 – Determining compensation actually paid for an equity award with a market condition that is met during the derived service period

A calendar-year registrant grants 100 stock options to its PEO on 1 January 2022. The award will vest and become exercisable if the registrant's share price reaches \$70 and doesn't fall below that price for 30 consecutive trading days and the executive is still with the company. Because this award contains a market condition, the registrant uses a Monte Carlo simulation to determine that the grant date fair value is \$1,000 and the derived service period is estimated to be three years, the period over which the compensation expense is recognized. The grant date fair value will be included in the summary compensation table for the year ended 31 December 2022, the year in which the award was granted.

Year 1 – 31 December 2022

On 31 December 2022, the registrant remeasures the fair value of the unvested options as \$1,250, using the same valuation methodology. To calculate the actual compensation paid to the PEO for the year ended 31 December 2022, the registrant deducts the \$1,000 grant date fair value reflected in the summary compensation table for the award and adds \$1,250, which represents the fair value of the outstanding and unvested award as of 31 December 2022.

Year 2 – 31 December 2023

On 31 December 2023, the registrant remeasures the fair value of the unvested options at \$1,050, using the same valuation methodology. Since the award was granted in the prior year, no amounts are included in the summary compensation table for the year ended 31 December 2023. To calculate the actual compensation paid to the PEO for the year ended 31 December 2023 for the PvP table, the registrant deducts \$200, which represents the decrease in the fair value of the outstanding and unvested award as of 31 December 2023.

Year 3 – 31 December 2024

On 31 December 2024, the market condition of the award is achieved, the award is exercisable and the fair value of the award at that time is \$1,500. To calculate the actual compensation paid to the PEO for the year ended 31 December 2024, the registrant adds \$450, which represents the increase in the fair value of the award from 31 December 2023 through 31 December 2024.

Illustration 3 – Determining compensation actually paid for an equity award with a market condition that is met after the derived service period

Assume the same facts as Illustration 2, except the market condition has not been met as of 31 December 2024 but is met in 2025.

Year 3 – 31 December 2024

On 31 December 2024, the compensation cost for the award has been fully recognized in the registrant's financial statements based on the award's derived service period, but the market condition of the award has not been met (i.e., the award is not exercisable). Based on the SEC staff's view, the registrant should continue to include the award in the PvP table and remeasure it as of year end. The fair value of the award as of 31 December 2024 is \$1,000. To calculate the actual compensation paid to the PEO for the year ended 31 December 2024, the registrant subtracts \$50, which represents the decrease in the fair value of the award from 31 December 2023 through 31 December 2024.

Year 4 – 31 December 2025

On 31 December 2025, the market condition of the award is achieved, the award is exercisable and the fair value of the award at that time is \$1,450. To calculate the actual compensation paid to the PEO for the year ended 31 December 2025, the registrant adds \$450, which represents the increase in the fair value of the award from 31 December 2024 through 31 December 2025 (i.e., exercisable date because the market condition of the award is met).

In addition, if awards remain outstanding and have not vested because performance or market conditions were not met in an eligible year, but the awards can potentially vest in the future, registrants should not subtract the fair value of those awards when determining executive compensation actually paid.

If vesting of an award is accelerated when an employee becomes retirement eligible, vesting would occur for purposes of the PvP disclosures in the year that the employee becomes retirement eligible. However, if the award has other additional substantive conditions, such as a market condition, registrants must also consider those conditions when determining whether an award has vested.

Determining total shareholder return

For each fiscal year, registrants will be required to disclose their cumulative TSR and that of their peer group, both calculated and presented based on an initial fixed investment of \$100.

Both TSR and peer group TSR are determined in the same manner as is required by existing Item 201(e) of Regulation S-K. That is, TSR is calculated as the sum of (1) cumulative dividends (assuming dividend reinvestment) and (2) the increase or decrease in the company's stock price for the year, divided by the share price at the beginning of the year.

The cumulative amounts are also calculated in the same manner as is required for the performance graph required by Item 201(e) of Regulation S-K (i.e., the TSR for the first 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 the second years). The "measurement period" for the cumulative TSR is 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 TSR is being calculated. The closing price at the measurement point must be converted into a fixed investment of \$100 in the registrant's stock (or in the stock of the companies in the peer group).

Registrants are required to determine their peer group using one of the following: (1) a published industry or line-of-business index, (2) peer companies selected in good faith or (3) registrants with similar market capitalization, if certain criteria are met. Registrants are required to use the same peer group they use for the performance graph or the one used in the compensation discussion and analysis (CD&A). Registrants may use a peer group disclosed in its CD&A as its peer group for the purpose of the PvP disclosures, even if the group is not used for compensation "benchmarking" under Item 402 of Regulation S-K. To calculate peer group TSR, registrants are required to weight each issuer's TSR based on their stock market capitalization at the beginning of each period for which a return is reported.

A registrant that does not use a published industry or line-of-business index as its peer group is required to disclose the composition of the peer group in a footnote. Consistent with the approach taken in Item 201(e) of Regulation S-K, if a registrant changes the peer group for its PvP disclosure from one year to the next, it is not required to include tabular disclosure of peer group TSR for the new peer group for all periods presented. However, the registrant must disclose in a footnote the reason for the change and a comparison of its TSR to both the old and new peer groups.

Registrant's net income and its company-selected measure

A registrant is also required to disclose GAAP net income and the most important financial performance measure the registrant uses to link compensation paid to its PEOs and other NEOs to company performance for the most recently completed fiscal year (i.e., the company-selected measure). For example, if the company-selected measure for the most recent fiscal year is operating profit, the registrant would disclose its operating profit in each fiscal year presented on the PvP table.

If the registrant's "most important" measure is already included in the PvP table (i.e., net income), the registrant would select its next most important measure as its company-selected measure. A registrant may provide a company-selected measure that is derived from, is a component of or is similar to the measures that must be included in the PvP table, such as earnings per share, gross profit, income or loss from continuing operations, or relative total shareholder return.

The company-selected measure can be a non-GAAP financial measure. Consistent with the current CD&A provision, if a registrant uses a non-GAAP financial measure as its company-selected measure, the disclosure will not be subject to the general rules regarding disclosures

Registrants can select a non-GAAP financial measure as the most important financial measure they use to link executive compensation to their performance.

of non-GAAP financial measures (i.e., Regulation G and Item 10(e) of Regulation S-K) for the purposes of the table. However, the registrant must disclose how the number is calculated from its audited financial statements. If the same non-GAAP financial measure is used elsewhere in a registrant's filing, the general rules on non-GAAP measures would apply.

Registrants can use their stock price as a company-selected financial performance measure if it is a market condition in an incentive plan award or if it is used to determine the size of a bonus pool (i.e., if the registrant uses stock price to link compensation actually paid to its NEOs to company performance).

How we see it

A registrant that chooses a non-GAAP financial measure as its company-selected measure should limit its use to the PvP disclosure if the SEC staff has previously objected to its use of the measure in other places in its filing. Registrants also should consider whether the SEC staff would view any adjustments to such measures misleading under its interpretive guidance.²

Considerations in an initial public offering or restructuring

When calculating changes in the fair value of awards granted before an initial public offering (IPO), registrants should use the fair value of those awards as of the end of the prior fiscal year, rather than other dates (e.g., the date of the IPO).

If a registrant went public in the earliest year presented in the PvP table, it should calculate its TSR and the peer group TSR beginning from the registration date. The calculation is not required to cover any period before that date, when the stock was not publicly traded.

Registrants should include outstanding equity awards granted in fiscal years before an equity restructuring (e.g., a spin-off) that are retained by the PEO and the other NEOs following the transaction when calculating executive compensation actually paid. Registrants should also include any awards modified in connection with the equity restructuring and for which compensation cost will be recognized under ASC 718.

Tabular list of financial performance measures

The rules require registrants to provide an unranked list of at least three and up to seven financial performance measures that are the most important measures they use to link executive compensation actually paid to company performance for the most recent fiscal year. The company-selected measure included in the PvP table needs to be included in the tabular list.

If a registrant uses fewer than three performance measures, the registrant is only required to disclose the measures it actually uses. Nonfinancial performance measures (e.g., active customers, number of memberships, number of data breaches) can also be included in the list if such measures are among the registrant's most important performance measures.

Registrants may disclose the tabular list in three different ways: (1) one list for all NEOs, including the PEO, (2) two separate lists (i.e., one list for the PEO and one for the other NEOs) or (3) separate lists for the PEO and each other NEO. If the registrant elects to provide the tabular disclosure in multiple lists, each list must include three to seven metrics.

While registrants are not required to do this, they may disclose how the measures in the list are calculated and why the registrant uses them to link executive compensation to performance.

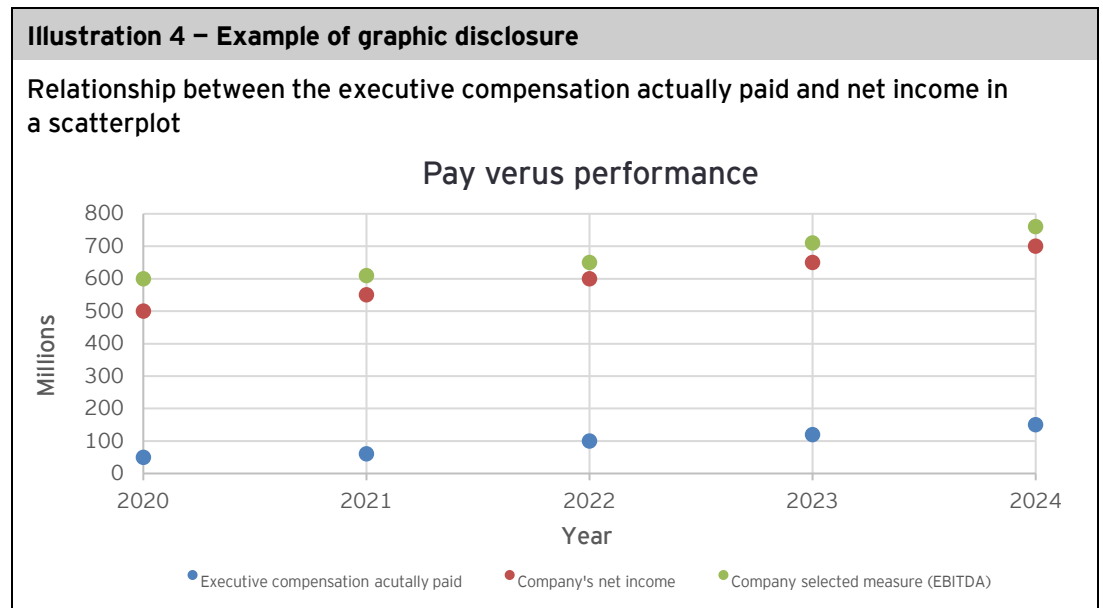
How we see it

We believe registrants may select financial performance measures that are similar to or the same as those included in CD&A. Registrants that select different measures may want to consider whether additional disclosure could be helpful in describing the relationship between these measures and executive compensation.

Description of relationship between pay and performance

Registrants will be required to describe the relationship between the actual executive compensation paid, as disclosed in the PvP table, and the registrant's TSR, net income and company-selected measure. Registrants will also be required to disclose the relationship between the company's TSR and the TSR of its selected peer group.

The relationships can be described in words, graphics or a combination of both. For example, a registrant may show the percentage change for each year in both executive compensation actually paid and net income together with a brief description of the relationship.



A registrant with multiple PEOs in a fiscal year may aggregate the PEOs' compensation for purposes of the narrative, graphical or combined comparison between "compensation actually paid" and TSR, net income and the company-selected measure if that presentation is not misleading to investors.

Supplemental disclosures

The rules permit registrants to voluntarily disclose other measures of compensation or financial performance measures, as long as these supplemental disclosures are not misleading or presented more prominently than the required disclosures. The supplemental disclosures may be presented in the table or in other disclosures, but each supplemental disclosure needs to be identified as supplemental.

Additional performance measures have to be accompanied by a clear description of the relationship between the measure and executive compensation actually paid to the registrant's executives.

Location of new disclosures and XBRL requirements

The rules do not specify the location of the PVP disclosures in the proxy or information statement. Registrants can include the PVP disclosures in CD&A if the information was considered in compensation decisions.

Registrants are required to separately tag each value disclosed in the table, block-text tag the footnote and relationship disclosed, and tag specific data points (e.g., quantitative amounts) in the footnote disclosures, all in Inline XBRL.

Smaller reporting companies

The rules provide the following scaled disclosures and other relief for SRCs:

- ▶ They only need to provide two years of disclosures in their first filings and three years of disclosures in subsequent filings.
- ▶ They are not required to make adjustments to pension amounts to calculate executive compensation actually paid.
- ▶ They are not required to disclose their peer group TSR, the company-selected measure or the tabular list of their most important financial performance measures.
- ▶ They are allowed to phase in Inline XBRL tagging (i.e., they can wait until the third filing in which they make PVP disclosures to tag them).

Transition

Registrants must begin to comply with the disclosure requirements in proxy and information statements that are required to include Item 402 executive compensation disclosures for fiscal years ending on or after 16 December 2022. That is, calendar-year companies will need to make these disclosures in proxy and information statements in early 2023.

In their first PVP disclosures, registrants except SRCs are only required to provide information for three years. They may add information for each additional year in their second and third filings. SRCs may provide the PVP disclosure for two years instead of three years in their first filings and add one additional year the following year. Registrants are permitted to provide additional years of disclosures as long as the information is not misleading and does not obscure the required information.

Transition for a newly public company

Newly public non-EGC registrants are required to provide the PVP disclosures only for the years they were considered reporting companies (i.e., required to file Form 10-K with the SEC). For example, a registrant that completed an IPO and became a reporting company in August 2023 would be required to provide disclosures only for 2023 (for the year of the IPO) in its first annual proxy statement filed in 2024. In its 2025 proxy statement, the registrant would only be required to provide the disclosures for 2023 and 2024. The registrant would add subsequent years to its annual proxy statement until it reaches five years of disclosures. If the registrant completed its IPO in 2023 before it issued its Form 10-K (e.g., February 2023), and provided its third-quarter 2022 financial statements as part of its registration statement, the registrant would be required to provide the disclosures for 2022.

Smaller reporting companies are only required to provide three years of pay versus performance disclosures.

Transition for a registrant that loses EGC status

An EGC that loses its EGC status at the end of its fiscal year (e.g., 31 December 2023) must comply with the final rules in its proxy statement filed the following year (e.g., spring of 2024). If the registrant qualifies as an SRC after it loses EGC status, it may provide the scaled disclosures for SRCs discussed above.

The SEC staff clarified that if a calendar-year EGC completes its IPO in March 2020 but loses its EGC status on 31 December 2023, the registrant is required to provide three years of PvP disclosures (or two years of PvP disclosures if it is an SRC) in its 2024 proxy or information statements, consistent with the transition provisions in Item 402(v)(8) of Regulation S-K and Instruction 1 to Item 402(v) of Regulation S-K.

How we see it

Registrants should establish a process to compile the PvP disclosures and make sure they have appropriate controls in place. Registrants also should consider whether their compensation committees will review draft calculations and disclosures and build any such reviews into their processes.

Finally, registrants should consider how they communicate executive compensation practices to stakeholders inside (e.g., CD&A) and outside of their SEC filings (e.g., investor presentations) and make sure that those communications align with the measures and narrative discussion included in their PvP disclosures.

Endnotes:

- ¹ While the PvP disclosures will be considered “filed” for Exchange Act liability purposes, they will not be deemed to be included in or incorporated by reference into filings under the Securities Act of 1933 or other filings under the Securities Exchange Act of 1934 (e.g., Form 10-K), unless a registrant explicitly incorporates them by reference.
- ² See the use of Non-GAAP Financial Measures Compliance & Disclosure Interpretations 100.01, 100.02, 100.03, 100.04, 100.05 and 100.06 at <https://www.sec.gov/corpfin/non-gaap-financial-measures>.

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