In brief

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SEC adopts pay versus performance disclosure rules

At a glance

The SEC has adopted amendments that require enhanced disclosures related to executive compensation in proxy and information statements for many registrants, as mandated by the Dodd-Frank Act.

What happened?

On August 25, the SEC adopted final rules, amending Item 402 of Regulation S-K to require registrants, other than foreign private issuers, registered investment companies, and emerging growth companies, to include incremental disclosures that depict the relationship between executive compensation actually paid and the financial performance of the registrant in proxy and information statements. The requirements apply differently to smaller reporting companies (SRCs), as discussed below.

The amendments require new tabular disclosure of total compensation for the principal executive officer (PEO) and the average for the other named executive officers (NEOs) for the five most recently completed fiscal years. The table must include both the total compensation included in the Summary Compensation Table and executive compensation actually paid as defined in the rule. Further, the table must show the following measures of financial performance:

- Total shareholder return (TSR) for the registrant
- TSR for the registrant's peer group
- The registrant's net income
- A "company selected measure" – a measure selected by and specific to the registrant that represents the most important financial performance measure (that is not already required to be included in the tabular presentation) used for the most recent fiscal year to link NEO compensation actually paid to company performance.

The rules require use of the following tabular disclosure:

Year	Summary Compensation Table Total for PEO	Compensation Actually Paid to PEO	Average Summary Compensation Table for Non-PEO NEOs	Average Compensation Actually Paid to Non-PEO NEOs	Value of Initial Fixed $100 Investment Based On:		Net Income	Company-Selected Measure
					Total Shareholder Return	Peer Group Total Shareholder Return		
Y1								
Y2								
Y3								
Y4								
Y5								

In addition to the tabular disclosure, registrants will be required to describe the relationships between (a) the executive compensation actually paid to the PEO and the average executive compensation actually paid to the other NEOs and (b) the financial performance measures, as disclosed in the table. The discussion must also include a comparison of the TSR of the company to the peer group TSR.

These descriptions need to address relationships for the five most recently completed fiscal years. Registrants have flexibility regarding how these disclosures are made, which may be graphical, in narrative form, or a combination thereof.

The amended rules also require that the registrant provide the three to seven most important financial performance measures used by the company to link executive compensation actually paid to the NEOs to company performance during the most recent fiscal year. The adopting release notes that the measures do not need to be ranked in order of importance. Fewer than three financial performance measures can be provided when there are fewer than three measures used to link executive compensation actually paid during the fiscal year to company performance. In addition to the financial measures, registrants may include non-financial performance measures used to link NEO compensation actually paid to company performance.

Registrants may voluntarily disclose supplemental measures of compensation and/or performance measures, however, any such disclosures must not be misleading nor be made with greater prominence than the required disclosures and must be clearly labeled as supplemental. Any additional performance measures voluntarily included in the tabular disclosure would also require a description of the relationship between said performance measures and executive compensation actually paid to the PEO and the average executive compensation actually paid to the other NEOs for the five most recently completed years.

The new required disclosures 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.

Required disclosures will be subject to Inline XBRL reporting and tagging requirements.

SRCs are subject to scaled reporting requirements. With respect to the tabular disclosures, SRCs are only required to include three years of data and are not required to include a peer group TSR or a company-selected measure. Accordingly, when describing the relationships between executive compensation actually paid and the financial performance measures, SRCs are only required to address the relationship to net income and the company's TSR. Additionally, SRCs are not required to provide a list of financial performance measures used by the company to link executive compensation actually paid to company performance.

Why is this important?

The final rules are intended to satisfy the mandate by Congress in the Dodd-Frank Act requiring disclosure linking executive compensation actually paid to company financial performance. The rules will result in incremental annual disclosure for impacted SEC registrants.

What's next?

The final rules will become effective 30 days after publication in the Federal Register. Registrants that are subject to the rules will be required to comply with the additional disclosure requirements in any proxy or information statements that require *Item 402 Executive Compensation* disclosures filed with the Commission related to fiscal years ending on or after December 16, 2022.

Only three years of information needs to be provided in the initial year of adoption, with an additional year added in each of the two subsequent annual filings in which the disclosure is required. SRCs may provide two years in the initial year, with a third year added in the subsequent year. There are also transition provisions applicable to new registrants, as explained in the rule.

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