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Memorandum

SEC Implements Dodd-Frank Pay Versus Performance Disclosure Rules

August 29, 2022

On August 25, 2022, the SEC adopted final rules implementing the pay versus performance disclosure requirement as required by Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[1] The SEC initially issued proposed rules that would amend Item 402 of Regulation S-K to implement this pay versus performance disclosure requirement in April 2015 and reopened the comment period for those proposed rules in January of this year.

The final rules will become effective 30 days following publication of the release in the Federal Register and will first apply to compensation disclosures for fiscal years ending on or after December 16, 2022. Accordingly, for calendar fiscal year issuers, the disclosures will first be required for the upcoming 2023 proxy season.

Final disclosure requirements: The final rules add new Item 402(v) of Regulation S-K, which requires registrants (other than emerging growth companies) to describe the relationship between the executive compensation actually paid by the registrant and the financial performance of the registrant in any proxy or information statement that otherwise requires executive compensation disclosure.

New 402(v) Table

New Item 402(v) of Regulation S-K requires tabular disclosure of the following for each of the last five fiscal years (three years in the case of smaller reporting companies):

(a) *The total principal executive officer ("PEO") compensation reported in the Summary Compensation Table;*

- If a registrant had multiple PEOs during a covered fiscal year, each PEO's compensation must be presented separately in the table.

(b) *The value of executive compensation "actually paid" to the PEO;*

[1] *See* Pay Versus Performance as well as Pay Versus Performance Fact Sheet.

- The final rules set forth detailed instructions to calculate compensation "actually paid." At a high-level, the final rules require that registrants:
  - deduct from the Summary Compensation Table total the aggregate change in the actuarial present value of all defined benefit and actuarial pension plans and to add back the aggregate of two components:

    (1) actuarially determined service cost for services rendered by the executive during the applicable year, calculated in accordance with U.S. GAAP; and

    (2) 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, calculated in accordance with U.S. GAAP.
  - include above-market or preferential earnings on deferred compensation that is not tax qualified in the "actual pay" amount.
  - deduct equity award amounts reported in the Summary Compensation Table total and to add or subtract the following in its place:
    - the year-end fair value of any equity awards granted in the covered fiscal year that are outstanding and unvested as of the end of the covered fiscal year;
    - the amount of change as of the end of the covered fiscal year (from the end of the prior fiscal year) in fair value of any awards granted in prior years that are outstanding and unvested as of the end of the covered fiscal year;
    - for awards that are granted and vest in the same covered fiscal year, the fair value as of the vesting date;
    - for awards granted in prior years that vest in the covered fiscal year, the amount equal to the change as of the vesting date (from the end of the prior fiscal year) in fair value;
    - for awards granted in prior years that are determined to fail to meet the applicable vesting conditions during the covered fiscal year, a deduction for the amount equal to the fair value at the end of the prior fiscal year; and
    - 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 reflected in the fair value of such award or included in any other component of total compensation for the covered fiscal year.

(c) *For named executive officers ("NEOs") (other than the PEO), the average total compensation reported in the Summary Compensation Table;*

- The SEC requires that registrants identify in footnote disclosure the individual NEOs whose compensation amounts are included in the average for each year, so that investors can consider whether changes in the average compensation reported from year to year were due to compositional changes in the included NEOs.

(d) *The value of the average executive compensation "actually paid" to the NEOs (other than the PEO);*

(e) *The value of a fixed investment scaled by cumulative total shareholder return ("TSR"), for the registrant; and weighted TSR for the registrant's selected peer group;*

- Registrants may use either the same peer group used for purposes of their annual report performance graph required under Item 201(e) of Regulation S-K or a peer group used in the CD&A for purposes of disclosing the registrant's compensation benchmarking practices.[2]

(f) *The registrant's net income;* and

(g) *A financial performance measure chosen by the registrant and specific to the registrant (the "Company-Selected Measure") that, in the registrant's assessment, represents the most important financial performance measure the registrant uses to link compensation actually paid to the registrant's NEOs to company performance for the most recently completed fiscal year.*

- Registrants may provide additional performance measures as new columns in the table.
- The Company-Selected Measure, or additional measures included in the table, may be non-GAAP financial measures. Consistent with other CD&A disclosure, non-GAAP measures are not subject to Regulation G and Item 10(e) of Regulation S-K; however, disclosure must be provided as to how the number is calculated from the registrant's audited financial statements.

[2] Consistent with the approach taken in Item 201(e) of Regulation S-K, if a registrant changes the peer group used in its pay versus performance disclosure from the one used in the previous fiscal year, it will only be required to include tabular disclosure of peer group TSR for that new peer group (for all years in the table), but must explain, in a footnote, the reason for the change and compare the registrant's TSR to that of both the old and the new group.

The tabular format required under the final rules is as follows:

PAY VERSUS PERFORMANCE

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)	[Company-Selected Measure]* (i)
					Total Shareholder Return (f)	Peer Group Total Shareholder Return* (g)		
Y1								
Y2								
Y3								
Y4 *								
Y5 *								

* These items indicate portions of the final rules from which smaller reporting companies ("SRCs") are exempt.

Clear Descriptions of Pay Versus Performance

In addition, registrants are required to use the information in the table to provide clear descriptions, over the registrant's five most recently completed fiscal years, of the relationships between compensation actually paid and three measures of financial performance, as follows:

- The relationship of (i) the executive compensation actually paid to the registrant's PEO and (ii) the average of the executive compensation actually paid to the registrant's remaining NEOs to each of:
  - the cumulative TSR of the registrant,
  - the net income of the registrant and
  - the registrant's Company-Selected Measure.[3]

Registrants are also required to provide a clear description of the relationship between the registrant's TSR and the TSR of the peer group chosen by the registrant. The final rules give the registrant flexibility as to the format in which to present the descriptions of these relationships, whether graphical, narrative, or a combination of the two.

[3] 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, for the last five completed years, between that additional measure and the (i) the executive compensation actually paid to the registrant's PEO and (ii) the average of the executive compensation actually paid to the registrant's remaining NEOs.

Tabular List of the "Most Important" Performance Measures

Further, new Item 402(v) of Regulation S-K requires disclosure of a list of the registrant's most important financial performance measures used by the registrant to link executive compensation actually paid to company performance (the "Tabular List") during the most recently completed fiscal year.

- Registrants must include at least *three* and up to *seven* performance measures in their Tabular List. Registrants can include non-financial performance measures in their Tabular List if such measures are among its three to seven most important performance measures and if the registrant has disclosed its most important three (or fewer, if the registrant only uses fewer) financial performance measures.

Only for Proxy and Information Statements: The final pay versus performance rules apply only to any proxy or information statement for which disclosure under Item 402 of Regulation S-K is required. These rules are not applicable to other filings where disclosure under Item 402 of Regulation S-K is required, including Annual Reports on Form 10-K and registration statements. In addition, the information disclosed 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.

XBRL Requirement: The final rules require registrants to separately tag each value disclosed in the new Item 402(v) table, block-text tag the footnote and pay-versus-performance relationship disclosure and tag specific data points (such as quantitative amounts) within the footnote disclosures, all in Inline XBRL.

Applicability: The final rules do not apply to emerging growth companies, registered investment companies or foreign private issuers. In addition, smaller reporting companies ("SRCs") are not required to provide Peer Group TSR and the Company Selected Measure in their 402(v) tables and are only required to include three, rather than five, fiscal years. Additionally, SRCs are not required to present the Tabular List of their most important performance measures or disclose amounts related to pensions for purposes of disclosing executive compensation actually paid.

Phase-In Periods: Registrants, other than SRCs, are required to provide the information for three years in the first proxy or information statement in which they provide the disclosure, adding an additional year of disclosure in each of the two subsequent annual proxy filings that require this disclosure. SRCs are initially required to provide the information for two years, adding an additional year of disclosure in the subsequent annual proxy or information statement that requires this disclosure. In addition, a SRC will only be required to provide the required Inline XBRL data beginning in the third filing in which it provides this disclosure.

Compliance Date: Companies must comply with these new disclosure requirements in their proxy and information statements that are required to include S-K Item 402 disclosure for fiscal years ending on or after *December 16, 2022*.

Conclusion

The SEC has taken the final step towards completing the executive compensation-related pay versus performance rulemaking triggered by the Dodd-Frank Act. While it may have taken some time to adopt these rules, registrants with a calendar fiscal year will be required to comply with these requirements in their next annual meeting proxy. While current CD&A requirements already require companies to describe the material performance measures used to determine the outcomes of a company's incentive compensation plans, given the short turn-around for compliance and the work necessary to generate the required disclosures, it is imperative that companies begin coordinating with their compensation consultants, review the performance metrics used in their programs and consider whether any changes should be made as a result of the final rules. Relatedly, thought and discussions should be had around identifying the Company-Selected Measure, other performance metrics to be included in the Tabular List, the alignment of these measures with the company's overall message to investors and potential broader implications (including the possible impact on say-on-pay voting) as companies gear up for the 2023 proxy season.

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