

CLIENT ALERT

## SEC Adopts Final Pay Versus Performance Rules

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### AUTHORS

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#### I. Overview.

On August 25, 2022, the SEC adopted new rules that will require each reporting company (other than an emerging growth company, a registered investment company or a foreign private issuer) to disclose the relationship between the compensation paid to its named executive officers (NEOs) and its financial performance (the “Final Rule,” available [here](#)) in any proxy or information statements for fiscal years ending on or after December 16, 2022.

#### II. New Pay Versus Performance Table.

The Final Rule will require the inclusion of a new Pay Versus Performance table (the “PvP Table”) in the following format (with items marked by (\*) not being required for smaller reporting companies):<sup>1</sup>

Pay Versus Performance

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:		Net Income	[Company Selected Measure]*
					Total Shareholder Return	Peer Group Total Shareholder Return*		
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
Y1								
Y2								
Y3								
Y4*								
Y5*								

<sup>1</sup> Additional columns will need to be added to the PvP Table in years when the reporting company has multiple PEOs.

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- *Year* (column (a)): The PVP Table will be required to include information for each of the five (or, for smaller reporting companies, three) most recently completed fiscal years, or the number of years in which the company was a reporting company, if less. Under a transition rule, companies are required to provide the proposed disclosure for the three (or, for smaller reporting companies, two) most recently completed fiscal years in the first applicable filing after the rules become effective, and to include an additional year in each subsequent annual filing in which disclosure is required until in full compliance.
- *Summary Compensation Table Total for PEO* (column (b)): The amount included in this column will be the amount reported for the company's Principal Executive Officer (PEO) in the "Total" column in the Summary Compensation Table (which is already required under Item 402 of Regulation S-K).
- *Compensation Actually Paid to PEO* (column (c)): The amount included in this column is the amount included in column (b), with the following adjustments:<sup>2</sup>
  1. subtract the grant date fair value of stock or option awards granted in the applicable year;
  2. add the year-end fair value of any stock or option awards granted in the covered fiscal year that are outstanding and unvested as of the end of the covered fiscal year;
  3. add the amount (positive or negative) of change as of the end of the covered fiscal year (from the end of the prior fiscal year) in fair value of any stock or option awards granted in prior years that are outstanding and unvested as of the end of the covered fiscal year;
  4. for stock or option awards that are granted and vest in the same covered fiscal year, add the fair value as of the vesting date;
  5. for stock or option awards granted in prior years that vest in the covered fiscal year, add the amount (positive or negative) of change in fair value from the end of the prior fiscal year to the vesting date;
  6. for stock or option awards granted in prior years that are determined to fail to meet the applicable vesting conditions during the covered fiscal year, subtract the amount equal to the fair value at the end of the prior fiscal year;
  7. 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 reflected in the fair value of such stock or option award or included in any other component of total compensation for the covered fiscal year;
  8. subtract the aggregate change in actuarial present value of all defined benefit and actuarial pension plans (other than for smaller reporting companies); and
  9. add the aggregate of (i) the actuarially determined cost for service rendered by the applicable executive during the applicable year under all defined benefit and actuarial pension plans (the "service cost") and (ii) the entire cost of benefits granted in an amendment to any defined benefit and actuarial pension plans during the covered fiscal year that are attributable to services rendered prior to the amendment (the "prior service costs") calculated in accordance with U.S. GAAP and FASB ASC Topic 715 (other than for smaller reporting companies).

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<sup>2</sup> The PVP Table will need to include footnotes disclosing the amounts deducted from and added to the amount reflected in column (b) and any valuation assumptions used in valuing equity.

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- *Average Summary Compensation Table Total for Non-PEO NEOs* (column (d)): The amount included in this column will be the average of the amounts reported for the company's named executive officers (other than the PEO) in the "Total" column in the Summary Compensation Table.
- *Compensation Actually Paid to Non-PEO NEOs* (column (e)): The amount included in this column will be the amount included in column (d), with the same adjustments as made to the PEO's compensation in column (c) being applied to each other NEO's compensation for the applicable fiscal year.<sup>3</sup>
- *Total Shareholder Return* (column (f)): The amount in this column will represent the value that a \$100 investment in the company's stock at the market close on the last trading day before the earliest fiscal year on the table would have at the end of the applicable fiscal year (taking into account any dividends that would have been paid in the interim).
- *Peer Group Total Shareholder Return* (column (g)): The amount in this column will represent the value that a \$100 investment pro rata in the stocks represented by the company's peer group at the market close on the last trading day before the earliest fiscal year on the table would have at the end of the applicable fiscal year (taking into account any dividends that would have been paid in the interim). For this purpose, the company's peer group can either be the company's peer group identified in the company's stock performance graph or in its Compensation Discussion and Analysis.
- *Net Income* (column (h)): The amount included in this column will be the company's net income (loss) for the applicable fiscal year.
- *Company Selected Measure* (column (i)): In this column, each company will be required to choose the financial measure that is "most important" to the company's compensation determinations for its NEOs (other than a measure that already appears on the table) and include such "company selected measure" in quantifiable terms in this column.

### III. Tabular List of Company's Most Important Performance Measures.

Each reporting company will also be required to separately list three to seven of the most important financial, and, if desired, non-financial, performance measures that the company used to link compensation actually paid to company performance based on the most recent fiscal year. One of the listed financial performance measures must be the "company selected measure" that is included in the PVP Table. The measures need not be ranked nor does the methodology for determining and calculating the measure need to be disclosed (although such methodology may be disclosed if necessary to prevent the disclosure from being misleading). The company may present one list for all NEOs, two lists (one for PEO(s) and one for the other NEOs), or a list for each NEO.

### IV. Narrative and/or Graphical Disclosure.

In addition to the required tabular disclosure, the Final Rule will require each reporting company to provide a clear description (using either or both of a narrative and a graphical disclosure) of the relationship between: (i) the compensation actually paid and the company's TSR, (ii) the company's TSR and the weighted TSR of the company's peer group for the last five years (other than for smaller reporting companies), (iii) compensation actually paid and net income, and (iv) compensation actually paid and the company-selected measure (other than for smaller reporting companies).

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<sup>3</sup> The PVP Table will need to include footnotes disclosing the amounts deducted from and added to the amount reflected in column (d) and any valuation assumptions used in valuing equity.

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### V. Immediate Action Required.

For most reporting companies, the new pay versus performance disclosure will need to appear in their 2023 proxy statements. We anticipate that a significant amount of lead time will be needed to gather and organize the information necessary to prepare compliant disclosure and additional time will then be needed to draft the actual disclosure. As a result, we recommend that those responsible for the preparation of a reporting company's proxy or information statements start coordinating in earnest with both their internal teams (e.g., compensation committees and finance and human resources teams) and external advisors (e.g., accounting firms, compensation consultants and legal advisors).

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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