

## SEC Pay vs. Performance Disclosure: Dodd Frank Section 953(a) Final Regulations

August 2022

# Rule Making History and Current Status

## Rule-Making History

- **July 2010:** Dodd Frank enacted; included § 953(a) requiring that public companies make new pay versus performance disclosures
- **April 2015:** SEC releases proposed regulations interpreting Dodd Frank § 953(a); comment period followed
- **February to March 2022:** SEC re-opens comment period on 2015 proposed regulations

## Current Status

- **August 25, 2022:** Final rules released
  - Additional guidance may be requested / needed due to material deviation from the proposed rules
- **Effective for Upcoming 2023 Proxy Statement:** New disclosures required for proxy statements attributable to fiscal years ending on or after December 16, 2022

# Overview of Disclosure Requirements

- **Location of Disclosure:** Required for all proxy statements; however, may be included in the Compensation Disclosure & Analysis (CD&A) or elsewhere
- **Tabular Disclosure:** New table required including the following items for the covered fiscal year as well as the 4 prior fiscal years (total of 5 years of disclosure; though a reduced time period for initial years of disclosure – see slide 11):
  - CEO Summary Compensation Table (SCT) total and compensation actually paid;
  - Average non-CEO named executive officer (NEO) SCT total and compensation actually paid;
  - Company total shareholder return (TSR);
  - Peer group TSR;
  - Company net income; and
  - Another company-selected financial performance measure
- **Narrative / Graphical Explanation:** Must include either narrative or graphical explanation / description of the following relationships:
  - CEO and average NEO compensation actually paid to company and peer group TSR;
  - CEO and average NEO compensation actually paid to company net income; and
  - CEO and average NEO compensation actually paid to additional company-selected financial performance measure
- **List of Performance Measures:** Must include an un-ranked list of the company's most important financial performance measures used during the covered fiscal year to link pay and performance (must be at least 3 but not more than 7 measures)
- **Limited Disclosure for Smaller Reporting Companies:** See slide 12 for additional information

# Tabular Disclosure – Sample Table

**Pay vs. Performance Table:** The table below shows the expected tabular disclosure formatting. The slides that follow include more detail on each column and additional disclosure requirements

Year	Summary Compensation Table Total for CEO (\$)	Average Summary Compensation Table Total for Other NEOs (\$)	Compensation Actually Paid to CEO (\$)	Average Compensation Actually Paid to Other NEOs (\$)	Total Shareholder Return (\$)	Peer Group Total Shareholder Return (\$)	Net Income (\$)	[Company-Selected Performance Measure]
Y1								
Y2								
Y3								
Y4								
Y5								

# Tabular Disclosure – Executives Covered

- **Principal Executive Officer:**

- Relevant amounts for the principal executive officer (i.e., the CEO) are reported separately
- **Multiple CEOs:** If there are multiple CEOs in a single fiscal year, additional columns must be added such that each CEO's compensation amounts are separately disclosed

- **Other Named Executive Officers:**

- Relevant amounts for NEOs other than the CEO are averaged for purposes of the remaining pay columns
- Must include a footnote listing by name the NEOs included for each of the reportable fiscal years (i.e., the covered fiscal year and 4 prior fiscal years; though a reduced time period for initial years of disclosure – see slide 11)

# Tabular Disclosure – CEO / NEO Pay Calculation

- **Summary Compensation Table Total:** These columns do not require any additional calculations. The company must simply include the number listed in the total column of the SCT for the CEO and the average of all the numbers listed in the SCT for the other NEOs.
- **Compensation Actually Paid – Overview:** Compensation actually paid is calculated by starting with SCT pay and then making certain adjustments related to pension plan value and equity awards
  - **One-Time Payments:** One-time payments (e.g., signing bonuses, severance payments, relocation benefits) are not deducted when calculating compensation actually paid
  - **Footnote Differences:** Must provide footnote disclosure of the specific amounts deducted from and added to SCT total compensation to determine compensation actually paid
- **Compensation Actually Paid – Pension Plan Adjustments:** The following adjustments must be made to SCT total to account for pension plan valuation when calculating compensation actually paid:
  - **DEDUCT** the aggregate change in the actuarial present value of all defined benefit and actuarial pension plans (no deduction if amount is negative)
  - **INCLUDE (calculated in accordance with GAAP)**
    - Service Cost: actuarially determined service cost for services rendered by the NEO during the covered fiscal year
    - Prior Service Cost: the entire cost of benefits granted in a plan amendment (or adoption) during the covered fiscal year that are attributed to services rendered in periods prior to the plan amendment (or adoption)

# Tabular Disclosure – CEO / NEO Pay Calculation

- **Compensation Actually Paid – Equity Award Adjustments:** The following adjustments must be made to SCT total to account for equity awards when calculating compensation actually paid:
  - **DEDUCT** any amounts reported in stock awards and option awards columns (i.e., grant date fair value of equity awards)
  - **INCLUDE**
    - Outstanding Unvested Equity Awards:
      - Year-end fair value of any outstanding and unvested equity awards granted in the covered fiscal year
      - Change in fair value as of the end of the covered fiscal year (compared to the end of the prior fiscal year) of any outstanding and unvested equity awards granted in prior years
    - Vested Equity Awards:
      - For equity awards that are granted and vest in the same covered fiscal year, the fair value as of the vesting date
      - For equity awards granted in prior fiscal years that vest in the covered fiscal year, the change in fair value as of the vesting date (compared to the end of the prior fiscal year)
    - Forfeited Equity Awards: for previously granted equity awards that fail to meet the applicable vesting conditions, deduct the fair value of such equity awards calculated as of the end of the *prior* fiscal year
    - Dividends / Earnings: add the value of any dividends or other earnings paid on equity awards in the covered fiscal year prior to the vesting date that are not otherwise reflected in the fair value or included in any other component of total compensation
  - **Valuation Assumptions:** Must include footnote disclosure of any valuation assumptions that materially differ from those disclosed at the time of grant

# Tabular Disclosure – Performance Measures

- **Company Total Shareholder Return:**
  - Must be calculated based on a fixed investment of \$100 at the measurement point
  - Must be calculated on a cumulative basis measured from the market close on the last trading day before the earliest fiscal year in the table through and including the end of the fiscal year for which TSR is being calculated (e.g., TSR over the first year, TSR over the first and second year, etc.)
- **Peer Group Total Shareholder Return:**
  - Must disclose weighted peer group TSR (weighted to market capitalization)
  - Must use the same peer group used for (i) the TSR performance graph included in the Form 10-K or (ii) the CD&A when disclosing compensation setting practices
  - **Changes in Peer Group:** If any changes are made to the peer group used in the previous fiscal years, only required to include tabular disclosure of new peer group TSR
    - Must also include a footnote that (i) explains the reason for the change in the peer group and (ii) compares the TSR of both the new and old peer group
- **Net Income:**
  - Calculated in accordance with generally accepted accounting principles (GAAP)
- **Company-Selected Measure:**
  - If most important performance measure is already included in the tabular disclosure (i.e., TSR or net income), must select the next most important measure
  - Must be a financial performance measure included in the list of the most important performance measures (as described on slide 10)
  - Must provide at least one company-selected measure; however, additional measures may be disclosed if not be misleading or presented with greater prominence than the required disclosure



# Narrative / Graphical Explanation

- **Comparison between Compensation and Each Performance Measure:** Must provide a clear description of the performance measure as compared to compensation actually paid, in narrative or graphical form, or combination of the two – specifically must explain:
  - CEO and average other NEO compensation actually paid compared to company TSR;
  - CEO and average other NEO compensation actually paid compared to peer group TSR;
  - CEO and average other NEO compensation actually paid compared to company net income; and
  - CEO and average other NEO compensation actually paid compared to company-selected financial performance measure
- **Sample Explanations:**
  - A **graph** providing compensation actually paid and change in the financial performance measure(s) on parallel axes and plotting compensation and such measure(s) over the required time period
  - A **narrative or tabular disclosure** showing the percentage change over each year of the required time period in both compensation actually paid and the financial performance measure(s) together with a brief discussion of how those changes are related

# List of Performance Measures

- **“Most Important” Performance Measures:** Must provide an un-ranked list of the most important financial performance measures used to link compensation actually paid to performance
  - **3 to 7 Performance Measures:** Must include at least three and up to seven most important financial performance measures; company-selected performance measure from table must be on the list
    - GAAP reconciliation required for any non-GAAP measures
  - **Most Recent Year Only:** Determined with respect to only the most recent completed fiscal year
  - **Non-Financial Measures Permitted:** May include non-financial performance measures in list if measures are among the most important performance measures and at least 3 (or, if fewer, all) financial performance measures are included in the list
  - **Cross-Reference Permitted:** May cross-reference to other disclosures (e.g., CD&A) that describe the processes and calculations
- **May Present Separate Lists, As Needed:**
  - May present one list with the performance measures applicable to all NEOs;
  - May present two separate lists: one for the CEO and one for remaining NEOs; or
  - May present a separate list for the CEO and each NEO

# Time Period Covered

- **Tabular Disclosure – Five Fiscal Years Included:**
  - Pay versus performance table must include all required information with respect to the fiscal year covered in the proxy statement as well as the four prior fiscal years
  - May provide additional years if doing so would not be misleading and would not obscure the required information
  - **Reduced Time Period for Initial Disclosures:**
    - First pay versus performance table must include all required information with respect to the fiscal year covered in the proxy statement as well as the two prior fiscal years
    - An additional year of disclosure must be included in each of the two subsequent filings
- **List of Financial Performance Measures – Covered Fiscal Year Only:**
  - Most important financial performance measures included in un-ranked list should be determined by looking only at the covered fiscal year (i.e., the most recently completed fiscal year)

# Limited Disclosure Requirements for Smaller Reporting Companies

- **Tabular Disclosure:**

- Not required to provide a peer group TSR, a company-selected performance measure, or to disclosure amounts related to pension plan valuations
- Pay versus performance table must include all required information with respect to the fiscal year covered in the proxy statement as well as the two prior fiscal years
- **Reduced Time Period for Initial Disclosure:**
  - First pay versus performance table must include all required information with respect to the fiscal year covered in the proxy statement as well as one prior fiscal year

- **Narrative / Graphical Explanation:**

- Not required to provide relationship disclosure with respect to peer group TSR or the company-selected performance measure

- **No List of Performance Measures:**

- Not required to provide a list of performance measures

# Next Steps / Action Items

- **Calculate Compensation Actually Paid:**
  - Engage pension plan actuaries and accountants overseeing equity award valuations to help with adjustments to SCT compensation totals
- **Determine TSR Peer Group:**
  - Review and compare TSR performance graph and CD&A peer groups to select peer group
  - Engage compensation committee and compensation consultant to make final determination
- **Identify Company-Selected and Most Important Performance Measures:**
  - Engage compensation committee and compensation consultant to identify potential company-selected performance measure to be included in table and list of most important performance measures
- **Prepare / Review Sample Graphical or Narrative Disclosures:**
  - Review prior year figures and prepare sample graphical and narrative disclosures showing the relationship between compensation actually paid and TSR, peer group TSR, net income, and company-selected performance measure
- **Determine Location of Disclosure:**
  - If included in CD&A, disclosure must be certified by the compensation committee