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GLOBAL PUBLIC COMPANY ACADEMY

The SEC’s New Pay for Performance Rules

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Pay Versus Performance: What to Expect in 2023

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Agenda

1. Review of the new disclosure requirements
2. Calculating compensation actually paid
3. Key tips and takeaways for implementation

Review of the New Disclosure Requirements

New SEC Disclosure Rules

- On August 25, 2022, the SEC adopted new rules to require enhanced pay for performance disclosure that will apply to 2023 proxies for calendar year-end companies.
- In 2015, the SEC proposed a new rule to implement Section 953(a) of the Dodd-Frank Act to require pay versus performance disclosure. The SEC reopened the comment period for the proposed rules in 2022 and subsequently included the "pay versus performance" final rules as part of its spring 2022 rulemaking agenda.
- New Item 402(v) of Regulation S-K requires companies to provide a table disclosing specified executive compensation and financial performance measures for their five most recently completed fiscal years.

New SEC Disclosure Rules (cont.)

- Registrants will be required to provide a list of three to seven financial performance measures that they determine are their most important performance measures for linking actual executive compensation to company performance.
- Smaller reporting companies will be subject to scaled disclosure requirements under the rules.

Pay Versus Performance Disclosure

- New Item 402(v) requires:
  - A tabular disclosure containing executive compensation and financial performance metrics, in each case over the last five fiscal years;
  - A clear description, either in narrative or graphical format, of the relationships between
    - (1) each of the financial performance measures included in the table and
    - (2) the executive compensation actually paid to the PEO and, on average, to the other NEOs; and
  - A list of three to seven financial performance measures (the “Tabular List”) that the registrant believes are its most important measures to link pay and performance, using the same approach as taken for the Company-Selected Measure

Pay Versus Performance Table

- The table required under new Item 402(v) requires disclosure containing the following information, in each case over the last five fiscal years:
  - "Total" compensation (using the Summary Compensation Table measure of total compensation)
  - Quantitative information reflecting "executive compensation actually paid" to NEOs, which is required on an individual basis for the PEO and as an average for the other NEOs
  - TSR for both the registrant and its peer group, based on a fixed $100 investment
  - The registrant's net income
  - A "Company-Selected Measure," which is a financial performance measure chosen by, and specific to, the registrant that represents, in the registrant's view, the most important financial performance measure it uses to link NEO pay and performance for the most recently completed fiscal year

New Item 402(v) Pay Versus Performance Table

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)		

Company-Selected Measure

- The Company-Selected Measure must reflect the registrant's assessment that it is the most important performance measure (that is not otherwise required to be disclosed in tabular disclosure required under Item 402(v) (i.e., TSR or net income)) for linking pay and performance.
- If the registrant's "most important" measure is already included in the Item 402(v) tabular disclosure (i.e., TSR or net income), the registrant would select its next most important measure as its Company-Selected Measure.
- Company-Selected Measures may differ from one year to the next.
- The Company-Selected Measure must be a financial performance measure included in the Tabular List.

Description of Relationship Between Compensation and Performance

- Companies must provide a clear description, either in narrative or graphical format, of the relationships between
  - each of the financial performance measures included in the table and
  - the executive compensation actually paid to the PEO and, on average, to the other NEOs.
- Companies must also describe the relationship between the registrant's TSR and its peer group TSR.

Tabular List

- Companies must also provide a list of three to seven financial performance measures that the company believes are its most important measures to link pay and performance, using the same approach as taken for the Company-Selected Measure.
- Companies are permitted, but not required, to include nonfinancial measures in the Tabular List if they consider such measures to be among their three to seven "most important" measures.
- Companies may provide the Tabular List disclosure as a single list, as two separate lists (one for the PEO and one for all NEOs other than the PEO), or as separate Tabular Lists for the PEO and each NEO other than the PEO.

Calculating Compensation Actually Paid

Overview

- The purpose of the disclosure is to show the value of compensation actually paid as compared to the company's financial performance.
- Compensation actually paid as calculated under these new rules is not the same as realized pay or even pay that has been received by these individuals during the prescribed year.
- For equity awards, the disclosure reflects incremental changes in value from the base value established in the year the award is granted.
- The cumulative value disclosed for each award should be equal to the final value as of the vesting date.

Compensation Elements

- The calculation includes the following three elements:
  - Cash compensation
    - Essentially the same as what is reported in the Summary Compensation Table.
  - Defined benefit pensions
    - Instead of using the change in pension value reported in the Summary Compensation Table, this calculation requires companies to calculate the pension service cost for the year.
  - Equity compensation
    - The rules require a very different approach than the 2015 proposed rules, which would have valued equity at vesting. The calculation is similar to the calculation of "realizable pay" but essentially marks to market unvested and outstanding equity awards based on their fair value from the grant date to the vesting date.

Pension Benefits

- Start with the “total” column from the Summary Compensation Table, which in the pay versus performance table is column (b) for the PEO and column (d) for the average for all other NEOs.
- Subtract the aggregate change in the actuarial present value of all defined benefit and actuarial pension plans, as reported in the Summary Compensation Table.
- Add the service cost and the prior service cost:
  - The service cost is the actuarially determined present value of benefits attributable to services rendered by the executive during the prescribed year, calculated in accordance with GAAP.
  - The prior service cost is only applicable to plan amendments or initiations made in the year and reflects the entire cost of benefits granted on account of a plan amendment (or initial plan adoption) during the prescribed year that are attributed by the benefit formula to services rendered prior to the plan amendment (or adoption), calculated in accordance with GAAP.
  - If the plan amendment reduces benefits related to prior service, the calculation would result in a negative amount that reduces the compensation actually paid.
- These are actuarial calculations and should be completed by the plan’s actuary.

Equity Compensation

- At a high level, the equity compensation calculation requires companies to revalue equity awards at the end of each year (or, the vesting date, if earlier) and report the change in value.
- The cumulative value disclosed for each award should be equal to the final value as of the vesting date.
- Awards granted in the prescribed year and awards granted in prior years require different calculations.
- Each unvested award needs to be revalued at the end of the year and each vested award is valued at the vesting date.
- Performance-based awards are valued based on the probability that the performance goals will be achieved.
  - If the performance goals are deemed improbable, the value is subtracted.
  - If the performance goals are deemed probable, the value is added.
  - The assumptions will need to be footnoted, which will require disclosure of performance earlier than companies normally would have disclosed performance after the end of the performance period.

Equity Compensation (cont.)

- Start with the "total" column from the Summary Compensation Table, as adjusted for the pension service cost.
- Subtract the grant-date fair value reported for equity awards in the Summary Compensation Table.
- Equity awards granted in the prescribed year:
  - Add the fair value at the end of the year if the award is outstanding and unvested as of the end of the year.
  - Add the fair value as of the vesting date if the award vested during the year.
  - Do nothing for awards that are forfeited during the year.

Equity Compensation (cont.)

- For awards granted in prior years:
  - Add or subtract any change in fair value as of the end of the prescribed year, as compared to the end of the prior year, if the award is outstanding and unvested as of the end of the year.
  - Add or subtract any change in fair value as of the vesting date, as compared to the end of the prior year, if the award vested during the prescribed year.
  - Subtract the fair value at the end of the prior year, if the award was forfeited during the prescribed year.
- Dividends:
  - Add any dividends or other earnings paid on awards in the prescribed year prior to the vesting date if not otherwise reflected in the fair value of the awards or included in any other component of total compensation for the year.

Additional Considerations

- When a new PEO or NEO enters the table in any of the five years, historical fair values will need to be calculated.
- Companies should plan on extensive footnote disclosures, including valuation assumptions.
- If companies grant options or performance-based awards that are measured based on market conditions (e.g., TSR), they will have to develop a mark-to-market valuation process.
- Any modifications during the year (e.g., repricings, changes to performance goals) will be reflected in the incremental difference between the end and beginning of year fair values.

Key Tips and Takeaways for Implementation

Challenges with the Disclosure Requirement

- No real “grace period” for implementing the disclosure
- Companies are not used to having to revalue their equity awards following the grant date fair value
- TSR as a challenge:
  - Many companies historically have not used TSR within their CD&A
  - Against the backdrop of the current macroeconomic environment – which is disparately impacting certain industries – TSR may look particularly challenged for certain companies as compared to the selected peer group
- Time/expense associated with calculating the amounts to be shown in the table

Challenges with the Disclosure Requirement (cont.)

- Will this disclosure –
  - Adversely impact say-on-pay results?
  - Invite questions from activist stockholders or others as to why a company chooses a particular "Company-Selected Measure" that differs from the peer group?

What Should You Be Considering Now?

- Work should be started now to avoid a time crunch and any process issues
  - Assume that the SEC will not change the compliance deadline
- Establish how to run the calculations and whether this will be done internally or through a third party
  - Consider any historical pension and equity award adjustments
  - Prepare “mock-ups” of tabular disclosure
  - Get your “process” in order by running valuations for prior measurement dates
  - Internal finance and executive compensation teams should be coordinating closely

What Should You Be Considering Now? (cont.)

- Begin considering what financial performance measure should be utilized as the Company-Selected Measure for 2022
- Consider what additional narrative disclosures may be needed to explain the disclosure through the retrospective lens
- Coordinate with Compensation Committee and independent compensation consultant
- Evaluate whether additional narrative disclosure will be needed to explain the relationship among (i) CD&A disclosure, (ii) compensation actually paid, and (iii) realized or realizable compensation

Determining Company Peer Group for TSR

- The peer group can be either:
  - the Regulation S-K Item 201(e)(1)(ii) peer group used in the company's Form 10-K performance graph; or
  - the CD&A peer group described in the Compensation Discussion & Analysis ("CD&A") of its proxy statement.
- If the peer group is not a published index, the company would be required to disclose the identity of the companies comprising the peer group via footnote to the pay versus performance table.
- If the company has previously disclosed the peer group companies in prior filings, the company may comply with the disclosure requirement by incorporation by reference to those filings.

Placement of PvP Disclosure

- New Item 402(v) does not specify the location of the new disclosure within the proxy statement.
  - It does **not** have to be contained in the CD&A
- SEC noted that mandating PvP disclosure in the CD&A section of the proxy statement may cause confusion by suggesting that the company considered the pay versus performance relationship in its compensation decisions.
- Typically, the CD&A information doesn’t relate to compensation “actually paid,” so there could be a mismatch (real or perceived) by including this information within the CD&A.

Non-GAAP Financial Measures

- Companies may opt to provide a non-GAAP financial measure as their Company-Selected Measure (or as one of the additional measures.
- Disclosure must be provided as to how the number is calculated from the company's audited financial statements.
- If the Company-Selected Measure or any additional measures that the company elects to provide in the Pay Versus Performance Table are non-GAAP financial measures, will not be subject to Regulation G and Item 10(e) of Regulation S-K.

Interplay with ESG Performance

- The final rules bucket ESG metrics as nonfinancial performance goals, along with measures of individual performance or broader "strategic goals."
- While the final rules do not require disclosure of ESG metrics, registrants may supplement their mandatory pay-for-performance disclosure with a discussion of ESG metrics (or any other nonfinancial performance measure), consistent with the requirements of Item 402(v)(6)(iii).
- Consider that – like other nonfinancial goal-oriented metrics – ESG-related goals will require advance planning and thought as to how achievement will be determined and reflected in the disclosure.

Common Questions

- Should we include PvP within our CD&A?
- Should we use our S-K Item 201(e) peer group or our CD&A peer group?
- How should we think about, and select, the Company-Selected Measure?
- What are some of the unintended consequences or risks that Compensation Committees should be aware of?

New Registrants

- Information for fiscal years prior to the last completed fiscal year will not be required if the registrant was not required to report under the Exchange Act at any time during that year.
- For example, a company with a calendar fiscal year-end that goes public in 2023 would not be required to provide pay versus performance disclosure beyond fiscal year 2022.

Smaller Reporting Companies

- Smaller reporting companies (SRCs) are exempt from a number of the new disclosure requirements. Specifically, SRCs:
  - May elect to provide only three years of pay versus performance disclosure instead of five years;
  - Are permitted to provide only two years of disclosure (instead of three) in the first filing that includes pay versus performance disclosure;
  - Are not required to disclose amounts related to pensions for purposes of disclosing executive compensation actually paid;
  - Are not required to present peer group TSR or a Company-Selected Measure in the pay versus performance table;
  - Are not required to provide the Tabular List of the three to seven most important financial performance measures; and
  - Are only required to provide pay versus performance disclosure in Inline XBRL as of the third filing in which they provide pay versus performance disclosure.

Smaller Reporting Companies (cont.)

- Smaller reporting companies will present their PvP disclosure using the following table:

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 Total Shareholder Return	Net Income
(a)	(b)	(c)	(d)	(e)	(f)	(g)
Y1						
Y2						
Y3						

Effectiveness and Compliance Deadline

- Registrants are required to comply with the new amendments in proxy and information statements that are required to include Item 402 executive compensation disclosure for fiscal years ending on or after December 16, 2022.
- Registrants may provide the disclosure for three years instead of five years in the first filing in which they provide pay versus performance disclosure, per Instruction 1 to Item 402(v).

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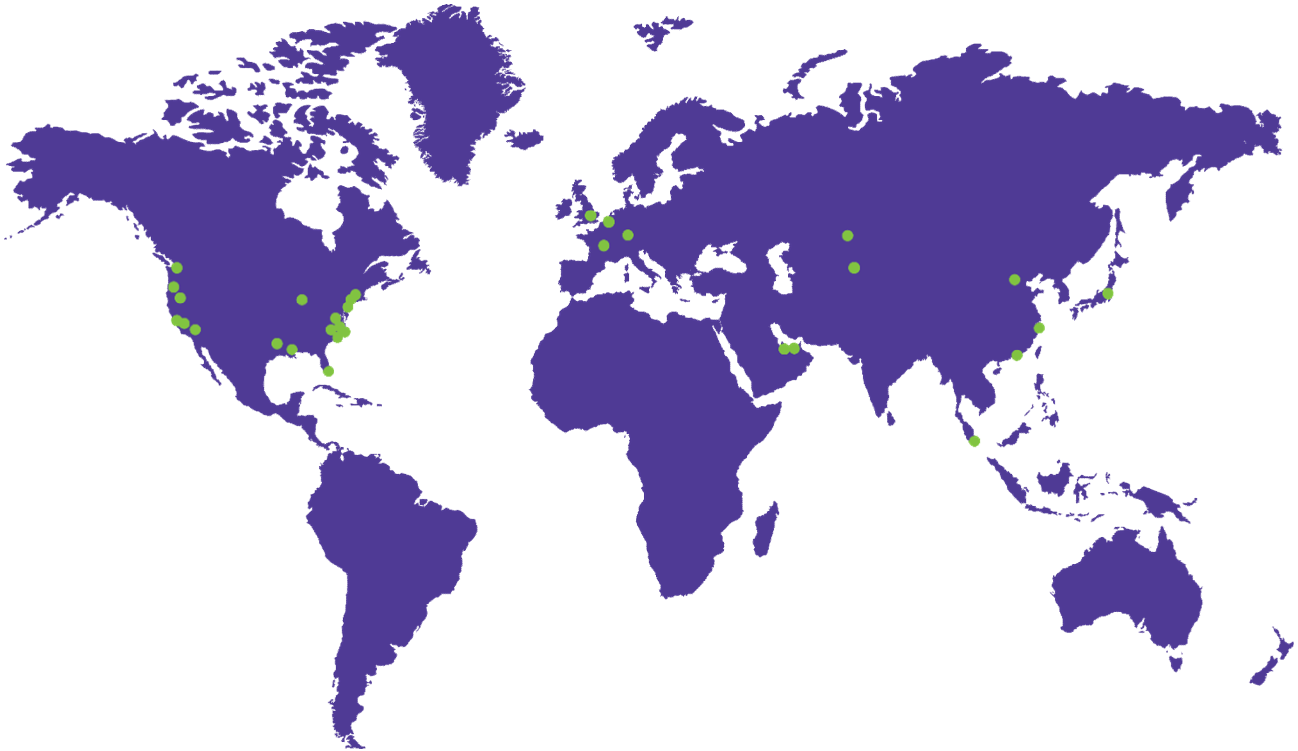

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