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SEC Adopts Long-Awaited Pay Versus Performance Disclosure Rule

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On August 25, 2022, the Securities and Exchange Commission, in a 3-2 vote, adopted a new disclosure rule implementing the Dodd-Frank Act's requirement that public companies disclose the relationship between compensation paid to executives and the company's financial performance. SEC Chair Gary Gensler's stated purpose of the new rule, commonly known as the "pay versus performance" disclosure requirement, is to promote transparency and make it easier for shareholders to assess a public company's decision-making with respect to its executive compensation policies.

With a few exceptions, all publicly traded companies must adhere to these new disclosure requirements. Because they will become effective 30 days following publication of the release in the Federal Register, most publicly traded companies with fiscal years ending on December 31, 2022 will need to include the "pay versus performance" disclosures in their proxy or information statements for 2023.

In particular, the rule amends Item 402(v) of Regulation S-K to require companies to include a new table in their proxy or information statements disclosing specified executive compensation and financial performance measures for the three to five most recently completed fiscal years (depending on the size and age of the company). This table must disclose the following information:

- A measure of total compensation for the company's principal executive officer and an average of total compensation paid to other named executive officers called the "Summary Compensation Table measure";
- Executive compensation actually paid to the principal executive officer and an average of the executive compensation actually paid to other named executive officers;

- The company’s cumulative total share return, as well as the total share return of its peer group;
- Net income of the company; and
- A company-selected financial performance measure that, according to the company, represents “the most important financial performance measure” that the company used for the most recent fiscal year.

In addition to disclosing the above information, companies must describe the relationships between the financial performance measures and the executive compensation “actually paid” to the principal executive officer (and the average compensation “actually paid” to other named executive officers).

The executive compensation “actually paid,” as it is defined in the rule, is a new concept that is meant to reflect the amount the officer takes home. The term is defined as “total compensation as reported in the Summary Compensation Table, modified to adjust the amounts included for pension benefits and equity awards.” Notably, the formula for determining compensation “actually paid” was one of the many issues Commissioner Hester M. Peirce, one of the two Republican Commissioners who voted against implementing the rule, flagged as problematic and likely to “elicit costly, complicated, disclosure of questionable utility.”

While the nuances and complex calculations associated with the disclosure rule may not outweigh its benefits to the public, complying with the rule within the allotted time period will be a significant undertaking for many companies. It also may make companies vulnerable to future securities lawsuits, especially in light of the complex calculation of the new compensation and performance metrics. Potential securities plaintiffs may closely review issuers’ 2023 public filings with an eye towards finding errors or discrepancies in their pay versus performance disclosures. As such, companies may want to begin collecting the relevant information sooner rather than later and ensure that any analysis or calculations they do in putting these disclosures together are well-documented.

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  Litigation Department Legal Director
- **Amy B. Gordon**
  Associate