

Securities and Capital Markets Blog

PRACTICAL SECURITIES LAW

An Early Look At SEC Comment Letters On Pay Versus Performance Disclosures

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Last year, the Securities and Exchange Commission (SEC) [adopted new rules](#) that implemented the pay versus performance (PVP) disclosure mandated by Congress in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The new rules require U.S. registrants to disclose the relationship between executive compensation and the financial performance of the registrant in their proxy and information statements. In general, the rules created new Item 402(v) of Regulation S-K, which requires registrants to:

- 1) Provide a table disclosing specified executive compensation and financial performance measures for their five most recently completed fiscal years. With respect to the measures of performance, registrants are required to report total shareholder return (TSR), the TSR of companies in the registrant's peer group, its net income, and a financial performance measure chosen by the registrant (Company-Selected Measure).
- 2) Describe the relationships between the executive compensation actually paid and each of the performance measures, as well as the relationship between the registrant's TSR and the TSR of its selected peer group. This can be provided either graphically, narratively, or a combination of the two.
- 3) Provide a list of three to seven financial performance measures that the registrant determines are its most important performance measures for linking executive compensation actually paid to company performance.

An Early Look at SEC Comment Letters on PVP Disclosure

Now that the new rules have been in effect for a year and the first cycle of disclosures has occurred, the SEC is conducting a targeted review of the disclosures and providing feedback in SEC staff comment letters. (We can tell the reviews are targeted to the pay versus performance disclosures because the beginning of such SEC staff comment letters contains the following sentence, "We have limited our review of your most recent definitive proxy statement to those issues we have addressed in our comments.") In monitoring recent SEC staff comment letters, we found the following early trends that SEC staff is focusing on in regards to compliance with the new rules:

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- **Providing clear descriptions of the relationship between compensation actually paid and net income.** SEC staff noted that clear descriptions must be provided as required by Regulation S-K Item 402(v)(5)(ii) and that it is not sufficient to state that no relationship exists, even if a particular measure is not used in setting compensation. (See [example letter 1](#) and [example letter 2](#).)
- **Using non-GAAP measures as the Company-Selected Measure.** SEC staff stated that registrants must provide disclosure showing how such numbers, including EBITDA and Adjusted Earnings Per Share, are calculated from audited financial statements, as required by Regulation S-K Item 402(v)(2)(v). If the disclosure appears in a different part of the definitive proxy statement, the disclosure requirement can be satisfied by a cross-reference, however, incorporation by reference to a separate filing will not satisfy this disclosure requirement. (See [example letter 3](#), [example letter 4](#), and [example letter 5](#).)
- **Identifying the principal executive officer (PEO), as well as each named executive officer (NEO), in the calculation of average non-PEO and non-NEO compensation.** SEC staff flagged that Regulation S-K 402(b)(3) requires the registrant to identify the principal executive officer, as well as each named executive officer included in the calculation of average non-PEO/NEO compensation, and the fiscal years in which such persons are included. (See [example letter 6](#).)
- **Ensuring that disclosures reflect accurate amounts and terminology from the pay versus performance table.** SEC staff stated that the requirement of Items 402(v)(5)(i) and (iii) is to describe the relationship between compensation actually paid and TSR, and compensation actually paid and the Company-Selected Measure, respectively. As such, the disclosures provided pursuant to Regulation S-K Item 402(v)(5) must reflect the correct amounts and terminology from the pay versus performance table. (See [example letter 7](#).)
- **Ensuring correct Summary Compensation Table amounts in pay versus performance tables.** SEC staff noted that Summary Compensation Table amounts must be accurate pursuant to Regulation S-K Item 402(v) and that the calculation of compensation actually paid and relationship disclosures must reflect the appropriate calculations. (See [example letter 8](#).)
- **Using accurate table headings and footnotes for pay versus performance table.** SEC staff cited unclear amounts reflected in the row titled “Year Over Year Change in Fair Value of Equity Awards Granted in Prior Years That Vested in the Year.” Specifically, equity awards granted in prior years that vest during the relevant year should be valued as the difference between the fair value as of the end of the prior fiscal year and the vesting date, not the “year over year” change in value. Further, SEC staff noted that table headings and footnotes must accurately reflect the amounts used to calculate compensation actually paid. (See [example letter 9](#).)
- **Including all required disclosures in pay versus performance table as reported in audited GAAP financial statements.** SEC staff emphasized that registrants may voluntarily provide supplemental measures of compensation or financial performance, so long as any additional disclosure is clearly identified as supplemental, not misleading, and not presented with greater prominence than the

required disclosure. (See [example letter 10.](#))

Given the impact the new rules have had on 2023 proxy statements, companies should take note of the early focus areas revealed by the first batch of SEC staff comment letters and others that will be forthcoming and draft accordingly for the next cycle. In particular, companies should focus on ensuring the clarity, accuracy, and thoroughness of the information provided in pay versus performance disclosures.

If you have any questions regarding any of the topics covered in this blog post, please feel free to email the authors directly or, if applicable, contact your primary Barnes & Thornburg relationship attorney.