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Kirkland Alert

SEC Staff Issues Guidance on Pay Versus Performance Disclosure Rules

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Overview

On February 10, 2023, the SEC staff issued guidance in the form of Compliance & Disclosure Interpretations ("C&DIs") with respect to the new Pay versus Performance ("PVP") disclosure rules. The PVP disclosure rules were adopted on August 25, 2022, and added a new Item 402(v) to Regulation S-K. Our initial *Alert* summarizing the PVP disclosure rules in more detail is linked here.

As a reminder, the PVP disclosures are required to be included in any proxy and information statements that are required to include Item 402 executive compensation disclosure for fiscal years ending on or after December 16, 2022, by a registrant other than an emerging growth company, foreign private issuer or registered investment company.

Below is a brief summary of the new PVP disclosure C&DIs. The full text of the C&DIs can be found here.

PVP Disclosure C&DIs

PVP Disclosure Not Required in Form 10-K. PVP disclosure is required only in a proxy or information statement that requires executive compensation disclosure pursuant to Item 402 of Regulation S-K and should not be included in the registrant's Form 10-K. Additionally, PVP disclosure will not be deemed incorporated by reference into any other SEC filing unless the registrant expressly incorporates it by reference. C&DI 128D.01

First-Time NEOs and Prior Equity Awards. Equity awards granted to a first-time named executive officer ("NEO") in a year prior to the year the executive became a NEO must be included for purposes of calculating the NEO's "compensation actually paid." C&DI 128D.02

> *Example: If a non-NEO was granted an equity award in 2020, and subsequently became a NEO in 2021, the NEO's "compensation actually paid" for 2021 must reflect the required fair value adjustments for the 2020 equity award.*

Footnote Disclosure of Adjustments. The PVP table must initially include footnote disclosure of each of the adjustments made for purposes of calculating "compensation actually paid" for each fiscal year included in the table. However, in subsequent years, footnote disclosure will only be required for the most recent fiscal year unless the prior year disclosure is material to an investor's understanding of the information reported for the most recent fiscal year, or the comparative disclosure provided under Item 402(v)(5). C&DI 128D.03

No Aggregation of Adjustments. Registrants cannot satisfy the required footnote disclosure regarding adjustments for the "compensation actually paid" calculations by providing the aggregate value of pension value and/or equity award adjustments, as applicable. Rather, a registrant is required to provide footnote disclosure of each of the adjustments made pursuant to each of Items 402(v)(2)(iii)(B) and (C). C&DI 128D.04

Compensation Peer Group Selection. For purposes of calculating a registrant's peer group total shareholder return ("TSR"), the registrant may use a peer group that is disclosed in its Compensation Discussion and Analysis ("CD&A") so long as that peer group is actually used by the registrant to help determine executive pay, even if that peer group is not used for "benchmarking" purposes (as such term is explained in C&DI 118.05). C&DI 128D.05

Calculating TSR for Newly Public Companies. If a registrant went public during the earliest year included in the PVP table, the "measurement point" for purposes of calculating TSR and peer group TSR should be the registration date (which is consistent with the calculation of TSR under Item 201(e) of Regulation S-K). C&DI 128D.06

Compensation Peer Group Changes. If a registrant is using its CD&A compensation peer group for purposes of calculating its peer group TSR, for each fiscal year included in the PVP table, the registrant must use the peer group that was disclosed in the CD&A for that fiscal year. C&DI 128D.07

> *Example: If a registrant used the same peer group in its CD&A for 2020 and 2021, but used a different peer group in its CD&A for 2022, then the registrant will be required to use (i) for 2020 and 2021, the peer group used in its CD&A for 2020 and 2021 and (ii) for 2022, the peer group used in its CD&A for 2022.*

Net Income Must be from Audited GAAP Financial Statements. The net income that is required to be provided in the PVP table must be the net income or loss as required by Regulation S-X to be disclosed in the registrant's audited GAAP financial statements. C&DI 128D.08

Company-Selected Measure as a Derivation of Net Income or TSR. A registrant's Company-Selected Measure can be derived from, a component of, or similar to the financial performance measures required to be included in the PVP table (i.e., net income and TSR). These measures can also be included as financial performance measures in the PVP tabular list. C&DI 128D.09

> *Example: Company-Selected Measures may include earnings per share, gross profit, income or loss from continuing operations, or relative TSR.*

Stock Price as the Company-Selected Measure. Stock price, even if it has a significant impact on the amounts reported in the PVP table, cannot be used as a registrant's Company-Selected Measure unless it is used as an actual performance measure (e.g., as a market condition applicable to an incentive plan award or to determine the size of a bonus pool). C&DI 128D.10

Company-Selected Measure and Multi-Year Performance Periods. A Company-Selected Measure cannot be a metric that is measured over a multi-year period since it must be the most important financial performance measure used by the registrant to link "compensation actually paid" to performance for the *most recently completed fiscal year*. C&DI 128D.11

Financial Performance Measures and Discretion. A registrant must identify a Company-Selected Measure if some portion of NEO compensation is tied to the achievement of a financial performance measure, even if the actual amount of compensation paid is subject to discretion. C&DI 128D.12

> *Example: If a registrant uses a bonus pool to determine annual bonus awards, with the pool availability and/or size based on the achievement of a certain financial performance measure, but the compensation committee has discretion to determine the actual bonus payouts, the registrant cannot take the position that there is no financial performance measure to disclose.*

Multiple PEOs and Comparative Disclosure. If a registrant has multiple principal executive officers ("PEOs") in a fiscal year, the registrant may aggregate its PEOs' compensation for purposes of the comparative graphical and/or narrative PVP disclosure requirement so long as the presentation is not misleading to investors. C&DI 128D.13

Change of Fiscal Year. If a registrant changes its fiscal year during the time period covered by the PVP table, the registrant must provide the relevant PVP disclosure for the "stub period" and should not annualize or restate compensation. The registrant should continue providing such disclosure including the stub period until there is disclosure for five full fiscal years after the stub period. C&DI 228D.01

> *Example: If a registrant that is not a smaller reporting company changed its fiscal year end in late 2022 from June 30 to December 31, the registrant's first PVP table must include disclosure for the following four periods: (i) July 1, 2022 to December 31, 2022, (ii) July 1, 2021 to June 30, 2022, (iii) July 1, 2020 to June 30, 2021, and (iv) July 1, 2019 to June 30, 2020.*

Emergence from Bankruptcy. If a registrant emerges from bankruptcy and a new class of stock is issued under the bankruptcy plan, the registrant may provide its TSR and peer group TSR using a measurement period that starts on the date its stock started trading. If the registrant uses this approach, it should provide appropriate footnote disclosure explaining this decision and its effect on the PVP table. C&DI 228D.02

Conclusion

This new guidance provides clarifications that are consistent with how many registrants have been interpreting the PVP disclosure rules thus far. That said, particular attention should be given to the new guidance on selecting, identifying and reporting of peer groups from year to year. Registrants who are in the process of preparing their PVP disclosures will need to immediately review this new guidance and determine how it impacts their draft calculations and disclosures.

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Suggested Reading

- 15 February 2023 Press Release Kirkland Advises Waters Corporation on Acquisition of Wyatt Technology
- 09 February 2023 Press Release Kirkland Advises Francisco Partners in Purchase of Sumo Logic for $1.7 Billion
- 08 February 2023 Press Release Kirkland Advises Oak Street Health, Inc. on $10.6 Billion Sale to CVS Health