KIRKLAND & ELLIS

Kirkland Alert

SEC Staff Issues Interpretive Guidance on Pay Versus Performance Disclosure Rules

04 October 2023

Overview

On September 27, 2023, the SEC staff issued additional interpretive guidance clarifying certain technical points regarding the Pay Versus Performance ("PVP") disclosure rules. The new guidance is in the form of 10 new Compliance & Disclosure Interpretations ("C&DIs") that supplement the 15 C&DIs issued by the SEC staff in February 2023 (previously summarized in our client *Alert*).

This guidance arrives as many registrants start preparation for the upcoming proxy season and the second year of PVP disclosure. The new C&DIs focus in large part on the calculation methodology of 'Compensation Actually Paid' as it relates to equity award adjustments. Under the PVP disclosure rules (previously summarized in our client *Alert*), registrants must include a table disclosing, among other things, for the principal executive officer and, as an average, for the other named executive officers, the Summary Compensation Table measure of total compensation as well as 'Compensation Actually Paid,' which reflects the total compensation reported in the Summary Compensation Table, but with certain adjustments to pension values and equity awards. Specifically, equity awards are adjusted by (i) subtracting the grant date fair value of the equity award amounts reported in the Summary Compensation Table for each applicable fiscal year, and (ii) adding or subtracting, as applicable, changes in fair value for awards that are outstanding and unvested at the end of the covered year, vest in the covered year or are forfeited in the covered year, as well as adding the dollar value of any dividends.

Below is a brief summary of the supplemental PVP disclosure C&DIs, the full text of which can be found here.

Awards Granted Prior to Certain Transactions

Awards Granted Prior to an Equity Restructuring. For purposes of calculating 'Compensation Actually Paid,' any equity awards that were granted prior to an equity restructuring (such as a spin-off) (i) that were outstanding and unvested at the beginning of the covered fiscal year or granted during the covered fiscal year (including awards modified in connection with any such restructuring) and (ii) for which a compensation charge under FASB ASC Topic 718 will be recognized, should be included. **C&DI 128D.14**

Awards Granted Prior to an Initial Public Offering. For purposes of calculating 'Compensation Actually Paid,' the change in fair value of equity awards granted prior to the date of a registrant's initial public offering must be based on the fair value of such awards as of the end of the prior fiscal year, and not based on the date of the initial public offering (or any other date). **C&DI 128D.15**

Impact of Vesting / Forfeiture

Awards that Vest Based on Market-Based Conditions. For purposes of calculating 'Compensation Actually Paid,' registrants must include the effect of a market condition when assessing changes in the FASB ASC Topic 718 fair value (and no award subject to a market condition will be considered "vested" until the market condition is satisfied). **C&DI 128D.16**

Potential for Vesting in Future Years. The fair value of any equity awards that fail to meet a vesting condition (such as a performance or market condition) in the reporting year but remain outstanding and eligible to vest in future years, should not be subtracted (i.e., these awards should not be treated as being forfeited) for purposes of calculating 'Compensation Actually Paid'. **C&DI 128D.17**

Retirement Vesting. In calculating 'Compensation Actually Paid,' equity awards that provide for accelerated vesting if the holder becomes retirement eligible should be reported as vested as of the date the holder becomes retirement eligible, unless the award has additional substantive vesting conditions. **C&DI 128D.18**

Certification of Performance. For purposes of calculating 'Compensation Actually Paid,' a performance-based vesting condition is generally considered satisfied as of the date on which the applicable condition is achieved, notwithstanding the fact that the certification of such achievement may occur in the following year. However, if certification is an additional substantive vesting condition, then the award would not be considered vested until such certification has occurred. Any provision that requires a registrant's board of directors (or a committee thereof) to certify the level of performance attained should be analyzed to determine if it creates an additional substantive vesting condition (such as a requirement for continued employment through the date of such certification). **C&DI 128D.19**

Valuation Methodologies

Valuation Techniques. For purposes of calculating 'Compensation Actually Paid,' registrants are required to compute the fair value of stock and option awards in a manner consistent with the methodology used to account for share-based payments under GAAP. A registrant may satisfy this requirement by using a valuation technique that differs from the one used to determine the grant date fair value of such equity-based awards in the registrant's financial statements, so long as such valuation technique would be permitted under FASB ASC Topic 718. However, if the change in valuation technique differs materially from the valuation technique used to determine the grant date fair value, the registrant must disclose the change in valuation technique and the reason for the change. **C&DI 128D.20**

GAAP Methodologies. The methodology and assumptions used to compute the fair value of stock and option awards for purposes of calculating 'Compensation Actually Paid' must be consistent with FASB ASC Topic 718. A registrant cannot compute the fair value of stock or option awards using another methodology or assumption that is not acceptable under GAAP. **C&DI 128D.21**

Non-GAAP Financial Information

Non-GAAP Financial Measures. C&DI 118.08 has been updated to clarify that Instruction 5 to Item 402(b) also applies to non-GAAP measures presented for purposes of the Company-Selected Measure or additional financial performance measures disclosed pursuant to Item 402(v)(2)(vi) of Regulation S-K (i.e., for PVP purposes). Therefore, presentation of non-GAAP measures in these instances does not require compliance with Regulation G or Item 10(e) of Regulation S-K (i.e., definition of the measure, more or equal prominence of GAAP measures and reconciliations to the most closely comparable measure). However, disclosure must be provided as to how the measure is calculated from the registrant's audited financial statements. **C&DI 118.08**

Other Disclosures

Disclosure of Confidential Information. Item 402(v)(4) requires disclosure of any material differences in the assumptions used to calculate the equity award values for purposes of 'Compensation Actually Paid,' and those used to calculate the grant date fair values reported in the registrant's financial statements. However, a registrant is not required to include detailed information with respect to quantitative and/or qualitative performance-vesting conditions in its PVP disclosure if such information would be covered by the confidentiality protections of Instruction 4 to Item 402(b) of Regulation S-K — Instruction 4 to Item 402(b) sets a high bar requiring a registrant to demonstrate that such disclosure would result in competitive harm if publicly disclosed. Even if a registrant invokes these confidentiality protections, the registrant must still provide disclosure that is as responsive as possible to the applicable PVP rules without disclosing such confidential information (such as a range of outcomes or a discussion on how a performance condition impacted the fair value). Further, the registrant should discuss how the material difference in the assumption affects the difficulty for the executive (or the likelihood for the registrant) to achieve the undisclosed target levels. **C&DI 128D.22**

Conclusion

This staff guidance provides clarifications that are generally consistent with how many registrants appear to have been interpreting the PVP rules thus far. Registrants should closely review this supplemental guidance and ensure that their PVP calculations and disclosures are consistent with these clarifications.

Authors

Kaitlyn I. Reid

Partner / New York

Steph Matko

Partner / New York

Abigail Lane

Partner / New York

Stephen M. Jacobson, P.C.

Partner / Houston

Travis N. Bruno

Associate / New York

Related Services

Practices

- Executive Compensation

Suggested Reading

- 03 October 2023 Press Release Kirkland Advises Brookfield and Everise on Investment in Everise by Warburg Pincus
- 02 October 2023 Press Release Kirkland & Ellis Announces New Partners
- 26 September 2023 Press Release Kirkland Advises LM Energy on Carveout Sale of Touchdown Crude Oil Gathering Business